FLY BOOK

ADVANCED BOOK-KEEPING

A TEXTBOOK FOR THE ADVANCED STUDENT

BY

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PREFACE

THE primary object of this work is to assist those candidates who are preparing for the examinations of the Royal Society of Arts (Stage III), the London Chamber of Commerce (Senior), and other advanced Book-keeping examinations conducted by similar examining bodies.

Though this book therefore deals, in the main, with the more advanced aspects, the theoretical principles of the subject have not been entirely ignored, and a brief review of these has been made in order that the book may form a complete study. To ensure that no doubt should exist as to the correct application of the fundamental rules, each section of the work is clearly treated, and where necessary, special examples are worked to explain and amplify the reading matter; and, by including a number of questions at the end of each chapter, the author has sought to increase the utility of the book by providing the student with that practice so vitally necessary if examination questions are to be answered accurately, yet with ease and rapidity. Key answers to the exercises are also given and these should prove of inestimable value both to the student, who is thereby enabled to check his work, and to the teacher, who is excused the rather irksome task of working exercises preparatory to the marking of papers.

The examination papers from which the questions have been selected include those of the Corporation of Accountants, the Central Association of Accountants, the Royal Society of Arts, the London Chamber of Commerce, and the Institute of Book-keepers, to whom acknowledgment is here accorded.

H. J. C.

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ADVANCED BOOK-KEEPING

CHAPTER I

BRIEF REVISION OF ELEMENTARY PRINCIPLES

SINCE the object of this book is primarily an explanation of the principles of Advanced Book-keeping, it must necessarily be assumed that the reader already has a good knowledge of the theoretical part of the subject in all its aspects. But mainly with a view to refreshing his knowledge, this chapter is devoted to a revision of first principles and their application to the more simple accounts that arise in the course of business trading. It is also necessary, if the book is to form a complete study, that a rapid review of the general elementary principles leading up to the Trial Balance be made.

The Double-entry System.

Modern book-keeping is based on what is known as the "double-entry" system. The axiom, "for every debit entry there must be a corresponding or credit entry, and *vice versa*," admirably summarizes its working, and, if it is continually borne in mind that the receiver is DEBITED and the giver CREDITED, no difficulty should be experienced in the preparation of accounts.

A very simple example will illustrate this fundamental principle of book-keeping. Smith sells a clock to Brown for £5. Smith's cash box receives £5, whilst his stock of clocks is reduced, the transaction appearing in his books as follows—

Cash (the receiving account) is *debited* with £5.
Goods (the giving account) is *credited* with £5.

If the clock is sold on credit—which simply means that payment is deferred—the entries in Smith's books would be slightly altered—

(*a*) At time of sale:

(i) Brown receives clock—*debit* Brown's Account with £5.

(ii) Smith's stock is reduced—*credit* Goods Account with £5.

(*b*) When payment is made:

(iii) Brown pays for clock—*credit* Brown's Account with £5.

(iv) Smith receives £5—*debit* Cash Account with £5.

Thus, Brown's Account contains debit and credit entries of £5, Cash Account a debit entry of £5, and Goods Account a credit entry of like amount, the net result of this transaction being precisely the same as if cash had been paid for the clock at the time of purchase.

BOOKS OF ORIGINAL ENTRY

These constitute the most important books which are kept to record the business transactions of a trader, partnership, or company. Some variation from these books may be necessary where the type of business demands it; for instance, a small trader may find it more convenient to use one book for two or more purposes.

Journal.

At one time the Journal was used to record the whole of the dealings of a business—the purchases, sales, cash receipts, and payments; in fact, it served as a memorandum book wherein particulars of every transaction could be found in chronological order. The complexity of modern business with such a multitude of items of much the same nature has rendered it necessary to keep separate books for different classes of entries, and it is to this that the introduction of subsidiary books is due. It is, therefore, usual to find the following subsidiary books or books of original entry in vogue—

1. Sales Book, recording sales.

2. Purchases Book, recording purchases.

3. Returns Books, recording goods returned to, and by, the business.

4. Bill Books, recording transactions in Bills of Exchange.

The Journal proper is now only used to record certain transactions which cannot be conveniently entered in the other books of original entry, viz. (1) opening and closing entries; (2) transfers and adjustments, and (3) correction of errors.

Cash Book.

The large number of cash dealings ordinarily occurring in any business necessitates the use of a separate book to record these dealings. Three columns are provided for Discount, Cash, and Bank, and posting is made direct from the Cash Book to the Ledger. Where the business is a large one, it may be advisable to keep separate books for cash received and cash paid, and to these the principle of analysis is extended, columns being included for every department, section of ledger, etc. The use of these columnar books avoids the tremendous amount of analysing which would be necessary were the more simple form of cash book kept.

Sales Book.

This book records particulars of all goods sold on credit. It is periodically totalled, the totals being credited to the Sales Account in the Ledger, and the individual items debited to the Personal Ledger accounts of the persons to whom goods have been sold. When the business is composed of several departments, or a number of commodities are sold, the Sales Book may be divided into columns for each department or commodity.

Purchases Book.

This will be similar in form to the Sales Book, the totals being periodically posted to the debit of the Purchases Account, and the individual amounts credited to the Personal Ledger accounts of the persons from whom goods are bought.

Returns Books.

For some reason or another, goods are invariably returned to, and by, the trader, and rather than pass these entries through the Purchases and Sales Books, separate books are kept to record details of returns *outwards* (Purchases Returns) and returns *inwards* (Sales Returns). Rulings similar to those of the Purchases and Sales Books will be used, and the totals of both books will be posted to the Purchases Returns and Sales Returns Accounts in the Ledger. The customer's account will be debited or credited according to the nature of the return, and so the double entry is complete.

Bill Books.

Different books will be in vogue for bills receivable and bills payable, both ruled with a number of columns so that full details of each bill can be entered. The totals of these books are posted to separate Ledger accounts, the individual items being posted to the credit side of the customer's account in the case of a bill receivable, and to the debit side in the case of a bill payable.

Petty Cash.

To relieve the Cash Book of much cumbersome detail, a separate book is used to record small cash transactions. The Petty Cash Book will be ruled with a number of credit columns so that an analysis of the payments may be made at the time of entry. Ledger accounts will be opened for each type of expense (in certain cases, one account is opened for General Expenses) to which the totals of the analysis columns are posted.

The most up-to-date method of keeping petty cash is that known as the "*Imprest System.*" A certain amount of money is, in the first instance, handed to the petty cashier, and at regular intervals a cheque is drawn representing exactly the sum he has spent, which, together with the cash balance he holds, brings the balance up to the "imprest" amount.

Bank Reconciliation Statement.

The introduction of the "Bank" column into the Cash Book and the opening of a banking account make it necessary for some agreement to be reached between the balance appearing in the trader's Pass Book (which is a copy of his account as it appears in the banker's books) and his Cash Book. The Pass Book is made up only at irregular intervals, and for any of the following reasons it rarely happens that at the end of the financial year this book agrees with the trader's books—

1. When amounts are paid into the bank or cheques are drawn in favour of creditors on the last day of the financial year.
2. Bank charges for interest and commission are entered in the Pass Book but not in the Cash Book.
3. Errors in either book.

The following is an example of a Bank Reconciliation Statement, in which the unpresented cheques are *deducted* from the balance shown by the Pass Book (since they would reduce it if they were presented for payment), and in which the uncleared cheques are *added* (since they would have increased the balance had they been cleared).

BANK RECONCILIATION STATEMENT

	£	s.	d.	£	s.	d.
Balance per Pass Book, 31st July, 19..				624	10	9
Less unpresented cheques—						
A. White	34	10	–			
Albany & Co.	120	9	2			
				154	19	2
				469	11	7
Add cheques not cleared—						
Surrey Trading Co.	40	6	–			
R. Mounsell	44	–	8			
				84	6	8
				£553	18	3

Where there is an overdraft at the bank, the cheques paid in but not cleared would be deducted from, and the unpresented cheques added to, the debit balance as shown by the Pass Book.

The Ledger.

This is the most important book in any system of book-keeping, for it contains in summarized form the whole of the transactions of a business. Where necessary, it may be divided into three or four books, thus—

(*a*) Purchases Ledger, consisting of the accounts of creditors to whom payment is due.

(*b*) Sales Ledger, used to record dealings with customers or debtors, who owe money to the business.

(*c*) General Ledger, embracing all other accounts, which may in turn be subdivided into: (1) Real Accounts—those recording transactions in tangible objects, e.g. cash, buildings, plant, and other assets or property, and (2) Nominal Accounts—those recording losses and expenses (wages, rent, etc.), and gains (interest and discount received).

At the close of the financial year the Ledger accounts are balanced; if the total of the debit side is greater than the total of the credit side, there is said to be a "debit balance on the account." Conversely, a "credit" balance is the excess of the credit side over the debit side. The balance is placed on the side with the smaller total, and then brought down as a balance to the succeeding period on the opposite side. It will be seen in the chapter that follows how many of the Ledger accounts are closed by transfer to the Trading and Profit and Loss Accounts.

Trial Balance.

When the Ledger balances have been ascertained, it is possible to extract the Trial Balance with Dr. and Cr. columns, by which the trader is enabled to test the arithmetical accuracy of his book-keeping entries. Agreement of the columns of a Trial Balance is not always proof of accuracy, for the following types of errors are not disclosed—

1. Errors of omission which relate to transactions the entries for which are omitted from the books.

2. Errors of commission which consist of entries placed to the wrong account, i.e. debiting Wages Account instead of Rates Account.

obligation to write down the value of this asset? (*b*) Is it a prudent commercial policy to reduce the book value of Goodwill from time to time? (L.C.C.)

G. Give the Journal entries necessary to record the following transactions in the books of J. James—

Jan. 1. He accepts a three months' bill for £350 10s. 6d. drawn by C. Clarke in favour of B. Brown.

Mar. 1. Brown agrees to the renewal of the Bill for a further three months plus interest at 5 per cent.

June 4. James makes a remittance by cheque in discharge of the Bill.

H. On 30th April, the Cash Book of Ring & Co. showed a balance overdrawn at the bank of £267 12s. A country cheque £678 2s. paid to bank on the 29th April had not been cleared, and the following cheques drawn upon the account had not been presented—

	£	*s.*	*d.*
W. Hodge	122	–	–
A. Smile	123	6	–

Upon comparing the Pass Book with the Cash Book it was discovered that the following entries did not appear in the Cash Book—

		£	*s.*	*d.*
April 30th.	Bill dishonoured .	298	12	–
	Cheque book .	1	–	–

The entries were made. Show by your workings the balance appearing in the Pass Book, and prove this by a reconciliation statement. (L.C.C.)

I. Enter up the following items in an analytical Petty Cash Book—

Imprest, £50; Carriage on parcel from Docks, 3s. 6d.; Cleaning Brasswork, 10s.; Stationery, 11s. 3d.; Stamping Policies, 9s. 6d.; Fare and Expenses, Manchester, £5 5s.; Periodicals, 14s.; Overtime to Juniors, £1 1s.; Fare, G.P.O., 6d.; Caretaker, 30s.; London Hospital, £1 1s.; Pencils, etc., 4s. 9d.; Fare, Westminster, 5d.; Stamps, £5.

Close off the entries and renew cash. (C.R.A.)

J. On 1st September, 19.., W. Wilkinson sends 100 Pianos to his agent, G. Gimlet, in New Zealand, at a value of £45 each. He paid cash for Freight, Insurance, etc., £294. On 1st December, G. Gimlet sent an Account Sales showing that he had sold 50 pianos at £60 each, his expenses being £37 and his commission 5 per cent on selling price. He sent sight draft for £2,500 on account. Show the transactions recorded in the Consignor's books as at 31st December, 19.. (I.B.)

K. L. Cooper's capital was represented by cash at the Midland Bank, £1,250. His weekly transactions through the bank were—

			Receipts from Customers			*Accounts Paid*			*Petty Cash Withdrawn*		
			£	s.	d.	£	s.	d.	£	s.	d.
Week ending	6th	December	251	3	4	133	10	–	100	–	–
,,	13th	,,	118	–	–	21	–	–	100	–	–
,,	20th	,,	339	16	8	555	15	–	100	–	–
,,	27th	,,	191	–	–	490	15	–	100	–	–

The business was that of a wholesale grocer. The petty cash was used for the payment of—

Salaries, £35 per week.
Personal Drawings, £15 per week.
Travellers' Commission paid 27th December, £55, and—

			Cash Purchases			*General Expenses*		
			£	s.	d.	£	s.	d.
Week ending	6th	December . .	29	18	–	3	5	9
,,	13th	,, . .	13	11	–	12	16	6
,,	20th	,, . .	28	17	–	11	1	3
,,	27th	,, . .	17	14	–	12	16	6

Rule a suitable Petty Cash Book and make the entries therein, prepare the Cash Book, post all the items to the Ledgers, and prove your accuracy by means of a Trial Balance. (R.S.A.)

CHAPTER II

TRADING ACCOUNTS; PROFIT AND LOSS ACCOUNTS; BALANCE SHEETS

THE chief object the book-keeper has in mind in recording the transactions of a business is the preparation of those accounts which will reveal—

(*a*) The final result of the trading operations, and

(*b*) The financial position of the business when the trading year comes to an end.

In order to attain this object it is necessary to summarize all the transactions and entries in the books and to prepare—

(i) The Trading Account;
(ii) The Profit and Loss Account, and
(iii) The Balance Sheet.

The Trading Account gives the *gross* profit for the period under review, i.e. the excess of the sale price of the goods sold over their purchase price, or over the cost of the raw materials and of converting these into saleable articles.

The Profit and Loss Account, consisting of the losses and expenses deducted from the gross profit, shows the *net* profit earned or loss sustained during the period.

The Balance Sheet, which is really a statement and not an account, shows in summary form the *assets* (property, book debts, plant, stock, and cash) possessed by the business, and the *liabilities* (amounts owing by the business to its creditors and proprietor).

The Trading Account.

This includes a summary of the buying and selling transactions of the business, amplified by the inclusion of a record of the stock of goods and materials on hand at the beginning and end of the trading period.

Before the Trading Account can be prepared, therefore, an inventory of the stock in hand must be taken. Stock should be valued at cost or market price, whichever is the lower

at the date of the accounts. Any loss in value should be provided for, but, except in certain circumstances, profit should never be anticipated, for it does not become tangible until the stock is actually sold. The original stock of goods is debited to a Stock Account which is closed, at the year end, by transfer to the Trading Account. The closing stock of one period, which is, of course, the opening stock of the next period, is debited to the new Stock Account, the credit entry appearing in the Trading Account.

Transfer is then made of the debit balance appearing in the Purchases Account to the debit of the Trading Account, and of the balance on the credit of the Sales Account to the credit of the Trading Account. The totals of the goods returned are deducted from the purchases and sales, and should not appear as separate items. The "Returns" figures will be obtained from the Returns Accounts in the Ledger which are closed by transfer in the same way as the Purchases and Sales Accounts.

Several other costs directly associated with the manufacture or production of goods must also be taken into account if the true trading or gross profit is to be calculated. Wages, as distinguished from office salaries, and carriage on goods purchased will be included, whilst it is not unusual to find such items as factory heating and rates, etc., also inserted. When all amounts have been taken into account it will be possible to strike a balance; a credit balance representing a profit, and a debit balance a loss, on trading. A specimen Trading Account is given below.

EXAMPLE I.

TRADING ACCOUNT

Dr. FOR THE YEAR ENDED 31ST DECEMBER, 19.. *Cr.*

	£	£		£	£
To Stock (1/1/19..)		10,000	By Sales	36,000	
„ Purchases	25,000		„ *Less* Returns	400	
Less Returns	100				35,600
		24,900	„ Stock (31/12/19..		9,300
„ Wages		2,500			
„ Carriage		500			
„ *Gross Profit* to Profit and Loss Account		7,000			
		£44,900			£44,900

The Stock Account in the Ledger would be represented thus—

Dr. STOCK ACCOUNT *Cr.*

19.. Jan. 1	To Balance .		£ 10,000	19.. Dec. 31	By Trading Account .		£ 10,000
19.. Dec. 31	To Trading Account .		9,300				

What has already been said applies more to the business in which goods are sold in the same state as to that in which they are purchased. The Trading Account of a manufacturer differs from that of the ordinary trader only in the entries to be found on the debit side of this account, since in his account must be included the direct costs of changing raw materials into saleable goods. Consequently, it is found that, in addition to being debited with purchases and wages, the manufacturer's account also includes factory rates and rents, taxes and insurance, factory heating and lighting, factory manager's salary, foremen's and storekeepers' wages, and similar *direct* charges which arise in the process of converting raw material and stock into the saleable or marketable articles.

The following is an example of a Manufacturer's Trading Account—

EXAMPLE 2.

TRADING ACCOUNT

Dr. FOR THE YEAR ENDED 31ST DECEMBER, 19.. *Cr.*

	£	£		£	£
To Stock (1/1/19..) .		15,000	By Sales . . .	87,000	
,, Purchases . .	60,000		*Less* Returns .	2,900	
Less Returns .	4,000				84,100
		56,000	,, Stock (31/12/19..) .		20,000
,, Factory Manager's Salary . . .		600			
,, Wages . . .		17,000			
,, Carriage Inwards .		2,000			
,, Lighting . . .		550			
,, Packing Expenses .		450			
,, Gross Profit c/d .		12,500			
		£104,100			£104,100

Profit and Loss Account.

This account, as its title implies, is a summary of the profits, losses, and expenses for the period of trading. It is

credited, by transfer, with the gross profit as shown in the Trading Account, and with sundry other incidental profits not derived from the buying and selling of goods, i.e. interest from bank and investments, and rents receivable. The whole of the balances of the nominal accounts remaining after the Trading Account has been prepared are transferred to the Profit and Loss Account, which is debited with all items of expense incurred in selling goods and also with the office and administrative costs.

Even from this information, however, it is not possible to determine the actual net profit or loss, because certain adjustments still require to be made. The more important of these come under three heads: (1) Reserve for bad debts and discount; (2) provision against depreciation; and (3) allowance for expenditure outstanding and that paid for in advance. It will be observed that the majority of these adjustments affect nominal accounts, so that effect must be given to them before the balances of the accounts concerned are transferred to the Profit and Loss Account.

To ensure that the debtors appear in the Balance Sheet as near as possible to their estimated value, it is prudent to make some reserve against likely bad debts and, sometimes, discount. This reserve may take the form of a fixed amount, but more often is a percentage of the debtors' total. For examination purposes the best method of showing this in the account is by debiting the reserve to the Bad Debts Account and by bringing down the reserve as a balance to the next financial year, thus—

Dr. BAD DEBTS ACCOUNT *Cr.*

19..		£	19..		£
Dec. 31	To Sundries . .	355	Dec. 31	By Profit and Loss Account . .	405
	,, Reserve c/d . .	50			
		£405			£405
			Dec. 31	By Reserve b/d . .	50

The Discounts Reserve is similar. If a reserve is made for Discounts Allowed, it would be shown in the Ledger Account as follows.

Dr. DISCOUNT ALLOWED ACCOUNT *Cr.*

		£			£
19.. Dec. 31	To Sundries . . .	285	19.. Dec. 31	By Profit and Loss Account . .	310
	,, Reserve for Discount on Debtors c/d . . .	25			
		£310			£310
			Dec. 31	By Reserve b/d . .	25

The profit and loss charge, therefore, includes both the actual loss and the reserve against contingent loss. A balance brought forward from the previous year must not be overlooked when the Bad Debts Reserve is being computed. If the method outlined above was adopted, only the balance of the Bad Debts Account would appear in the Profit and Loss Account, but very often in examination questions the balance of any previous reserve is given, which must then be dealt with in the following manner. Assuming, for example, the balance of the bad debts reserve to be £20 and that a reserve of 5 per cent is to be made on debtors amounting to £2,500, the entry in the Profit and Loss Account would be—

	£	£
Bad Debts Reserve (5% of £2,500) . .	125	
Less Amount of reserve b/f . .	20	
		105

There are many methods of providing for depreciation, and these are dealt with in detail in the chapter which follows. But, whichever method is adopted, the Profit and Loss Account is debited because depreciation is a charge against profit, to be taken into account irrespective of whether the ultimate result of trading be a profit or a loss. Where depreciation is charged by writing down the value of the asset every year, the credit entry is made in the particular asset account and shown as a deduction in the Balance Sheet, thus—

	£	£
Plant and Machinery . .	10,000	
Less Depreciation . .	1,000	
		9,000

It will be found in practice that only the net amount is given, a note sometimes being added giving the total depreciation charged since the asset was originally purchased. For examination work it is better to show depreciation as a deduction from the asset concerned.

In every business certain expenses are incurred which are paid in respect of a period of time and it often happens that the period covered by these payments does not coincide with the trading period. Consequently, it becomes necessary to make some apportionment so that each trading or financial year bears its true portion of these items. Assuming the rent of a business to be £400 per annum, that three quarters have been paid and that one quarter is outstanding, adjustment is made by debiting the nominal account with the portion of the expense which has accrued so that the transfer to profit and loss is increased to its proper amount. The portion unpaid is carried down as a balance to the succeeding financial year, being automatically cancelled when the next payment for rent takes place, thus—

Dr. RENT ACCOUNT *Cr.*

			£				£
19..	To Cash		100	19..	By Profit and Loss Account		400
	" "		100				
	" "		100				
	" Reserve for Rent due c/d		100				
			£400				£400
19..	To Cash		100	19..	By Reserve b/d		100

Similarly, other items, although paid, relate to a part of the period following that for which the accounts are prepared. Insurance payments, for instance, rarely cover the exact trading period and to adjust the nominal account, the portion unpaid is credited to the Insurance Account, thereby decreasing the profit and loss charge. This reserve is carried down to the next financial year in the same way as the rent due above, thus:

Dr. INSURANCE ACCOUNT Cr.

		£			£
19..	To Cash . . .	125	19..	By Reserve for Insurance prepaid c/d .	50
	,, ,, . . .	125		,, Profit and Loss Account . .	450
	,, ,, . . .	125			
	,, ,, . . .	125			
		£500			£500
19..	To Reserve b/d .	50			

The adjustments to be made preparatory to profit calculation having been dealt with, an illustration can now be given.

PROFIT AND LOSS ACCOUNT

Dr. FOR THE YEAR ENDED 31ST DECEMBER, 19.. Cr.

	£	£		£	£
To Salaries		1,200	By Gross Profit c/d . .		3,150
,, Rent, Rates, and Taxes .	310		,, Interest received . .		28
Add amount due . .	40				
		350			
,, Insurance . . .		170			
,, Carriage . . .		500			
,, Printing . . .		45			
,, Coal, Gas, and Water .	97				
Less amount prepaid .	12				
		85			
,, Postages . . .		33			
,, Bank Charges . .		20			
,, Sundry Expenses . .		28			
,, Loan Interest . .		25			
,, Reserve for Bad Debts .		135			
,, Depreciation—					
Plant 10% . . .	50				
Fixtures 5% . .	10				
		60			
,, Net Profit . .		527			
		£3,178			£3,178

The effect of the preparation of the Trading and Profit and Loss Accounts is that all nominal Ledger accounts have been closed by transferring the balances standing thereon to either of these summary accounts. The balances still left in the Ledger consist, therefore, of those of the *personal* accounts (debtors and creditors) and *real* accounts (property and other assets), and it is from these that the Balance Sheet may be prepared.

Balance Sheet.

The Balance Sheet is, therefore, a statement of balances from which should be gleaned the liabilities and assets of the

business and the general financial position existing at a particular date.

No longer are the prefixes "Dr." and "Cr.," and "To" and "By" used; instead the terms "liabilities" and "assets" are introduced. A further important departure from the accounts already discussed is that balances appearing on the debit side of ledger accounts are set out on the right-hand side of the Balance Sheet and those appearing in the Ledger as credit balances are included on the left-hand side of the Balance Sheet.

The order in which the assets and liabilities should be marshalled depends upon the business. In the case of sole traders and partnerships, it is usual to place the assets in order of liquidity, i.e. the ease with which they may be converted into cash, and the liabilities in the order in which they are paid, e.g. creditors being shown before the proprietor's capital. As will be seen in a later chapter, this order is more or less reversed when joint stock or limited companies' Balance Sheets are compiled.

Reserves for bad debts, depreciation, etc., are, for the purpose of example, deducted from the asset concerned and, although this method can be adopted in the examination room, it is often found, in practice, that only the net figure appears in the Balance Sheet, the total depreciation charged or deducted to the date of the accounts sometimes being stated.

BALANCE SHEET
AS AT 31ST DECEMBER, 19..

Liabilities	£	£	*Assets*	£	£
Sundry Creditors	3,100		Freehold Premises	3,000	
Rent accrued due	12		*Less* Depreciation	60	
		3,112			2,940
			Office Furniture		650
			Plant	550	
			Less Depreciation	50	
					500
			Stock		8,250
Capital Account	15,400		Sundry Debtors	5,535	
Add Net Profit for the year	2,751		*Less* Bad Debts Reserve	135	
		18,151			5,400
			Cash		80
			Bank		3,433
			Insurance prepaid		10
		£21,263			£21,263

CHAPTER III

DEPRECIATION; RESERVES; SINKING FUNDS

DEPRECIATION is the name given to the loss in value of an asset due to wear and tear, obsolescence and effluxion of time. It applies to that inherent wastage in value which affects practically every asset of a business, and since, in the majority of cases, the loss is a gradual one, it should be considered just as much a charge annually against profit as wages or carriage.

This loss in value may not be confined to any particular cause; a combination of wear and tear and obsolescence can, for instance, be responsible for the depreciation of plant and machinery. The view is wisely held that it is more economical to scrap machinery which has become out of date owing to the introduction of improved methods of manufacture and to install modern plant, than to continue the use of obsolete machinery as a result of which production is wasteful and expensive.

In the case of certain assets such as leasehold property and patent rights, the life of the asset is definitely known: at the end of a certain period it becomes valueless. Unless depreciation is charged annually this asset will continually appear in the books at its cost price until replacement becomes necessary. When replacement is made the cost of the new asset will have to be charged to the accounts for the year in which the change is made. It is, therefore, more equitable to write off a proportionate part of its cost over the whole of those years during which equal benefit is derived therefrom.

The value of assets as they appear in the Balance Sheet should be as near as possible to their actual or true value, and it is for this reason mainly that depreciation is taken into account. The Balance Sheet is a statement of values at a particular date, and if provision is not made for definite loss in the value of some of its constituent items, the statement

is not one of fact. This provision may be effected in two ways; either the value of the asset may be written down in the books and as a result profit conserved, or the asset may appear in the Balance Sheet at its original cost, the appropriations from profit being set aside in the form of a reserve or sinking fund, from the proceeds of which replacement may be made. The difference between these two methods is that, in the first, the sums charged as depreciation remain in the business, a surplus of assets over liabilities being essential for their existence; whereas, where the second method is adopted, sums are definitely set aside every year, and are represented by some actual fund. Here again, however, the existence of the fund, if not invested outside the business, is also dependent upon a surplus of assets. That the outside investment of sums charged for depreciation is accompanied by certain advantages can, even at this early stage, be appreciated.

As to which is the most suitable of the methods discussed later on is a matter of choice which must be decided by the individual student. Theoretically and practically, the decision will, in most cases, be determined by the asset concerned and the type of business carried on. It must not, however, be overlooked that what is considered to be a fixed asset in one business might be termed a floating asset in another. The chief reason depreciation on *floating* assets is emphasized is because these assets are held with a view to resale or early conversion into cash, and, as a result, they constantly vary, so that accurate valuation is necessary. Whereas, the valuation of fixed assets, apart from cases where the selling of a business as a going concern is contemplated, is not so important. Fixed assets are not acquired with a view to resale, and as long as their profit-bearing or revenue-earning capacity is in no way impaired, the valuation of these to the outside world is of little or no significance. In the case of certain fixed assets of a wasting nature, such as leaseholds or plant and machinery, where it is known that at the end of a certain time the asset will be of little or no value, it is advisable that the original cost be written off over a number of years.

There are, perhaps, two further points which ought to be dealt with before an outline of the various methods of providing for depreciation is given: (*a*) the fixing of the amount to be written off annually, and (*b*) whether, if certain methods are adopted, the provision made should be invested inside or outside the business. In the case of assets such as machinery it will first be necessary to calculate the "life" or productive capacity of the asset, and its probable residual value at the end of that term. The difference between the original capital outlay and the scrap value represents the amount of depreciation to be written off over the estimated life of the asset.

The second point arises where it is desired to set aside year by year a specific part of the profits so that, at the end of its life, an asset may be replaced without unduly disturbing the financial position of the business, which could hardly be avoided if the profit appropriated over a number of years was represented by stocks of goods. Should the sum yearly appropriated be retained in the business or invested in some outside security? Here, again, the type of business and its assets must play an important part in any decision reached. Additional capital upon which neither interest nor dividend is payable, is certainly of use for development and expansion. But, if this extra capital is tied up in fixed assets, what will be the position when the contingency for which these annual sums have been set aside urgently becomes a reality? Will the enforced sale of assets result in heavy material losses? In such circumstances, the advantage of outside investment is apparent. Provided a good class of security is selected, yielding a small return but capable of easy realization when necessary, this fear of loss does not arise.

It would appear, therefore, that where the assets of a business are such as will permit their necessary replacement without undue risk of loss, the annual depreciation appropriations may be retained within the business itself. But where these conditions do not exist it would seem to be more practicable to seek outside investment, if only to promote internal soundness.

Percentage on Original Cost.

This represents a fixed instalment of the original cost written off annually. Thus, a machine which costs £1,000, is estimated to have a useful life of twenty years and a residual value of £50. The depreciation of this machine is, therefore, £950 or $4\frac{3}{4}$ per cent on £1,000 to be written off every year. The annual charge is credited to the asset account which, after twenty years, is reduced to the estimated residual or scrap value as follows—

Dr. MACHINERY ACCOUNT *Cr.*

Year		£ s. d.	Year		£ s. d.
1	To Balance .	1,000 – –	1	By Profit and Loss Account .	47 10 –
			,,	,, Balance c/d .	952 10 –
		£1,000 – –			£1,000 – –
2	To Balance b/d .	952 10 –	2	By Profit and Loss Account .	47 10 –
			,,	,, Balance c/d .	905 – –
		£952 10 –			£952 10 –
3	To Balance b/d .	905 – –			
20	To Balance b/d .	97 10 –	20	By Profit and Loss Account .	47 10 –
				,, Balance c/d .	50 – –
		£97 10 –		*	£97 10 –
20	To Balance b/d .	£50 – –	20	By Cash (Proceeds from sale of scrap) . .	£50 – –

Some accountants hold the view that a separate account should be opened for the depreciation through which entries are passed before adjustment is made in the asset account. Except that it is useful as a summary where a number of depreciations are made every year, there appears to be no reason why entry should not be made direct to the asset account concerned.

The chief argument in favour of the fixed instalment method is that the loss is spread equally over a number of years. Whilst of such assets as leases and patent rights this contention is admitted, it is pointed out by the opponents of this method that for buildings and machinery which constantly need repair, the principle of equal charge does not obtain.

The costs of repairs naturally become heavier as the age of the asset progresses, with the result that the combined charge for depreciation and repairs is much greater in the later years of the life of the asset than in the earlier years. As an alternative, the system known as the "reducing instalment method" is put forward.

Reducing Instalment Method.

In this method, the amount of depreciation to be written off over the asset's life is determined in exactly the same way as that stated above, but instead of being a percentage of the original cost, it is based on the reduced annual value. The rate in the earlier years is, therefore, much heavier but it is claimed during these years that the cost of repairs is small, whilst, in later years, when the repairs charges become heavier, compensation is found in lighter depreciation charges. Consequently, the annual provision for both depreciation and repairs tends to be fairly equal over the life of the asset.

EXAMPLE 1. John Brown purchased machinery to the value of £20,000. He determined to write off for depreciation $7\frac{1}{2}$ per cent per annum upon the diminishing value. Show the Machinery Account in his books for the first three years.

Dr. MACHINERY ACCOUNT *Cr.*

Year		£	s.	d.	Year		£	s.	d.
1	To Balance	20,000	–	–	1	By Profit and Loss A/c ($7\frac{1}{2}$% on £20,000)	1,500	–	–
					,,	,, Balance c/d	18,500	–	–
		£20,000	–	–			£20,000	–	–
2	To Balance b/d	18,500	–	–	2	By Profit and Loss A/c ($7\frac{1}{2}$% on £18,500)	1,387	10	–
					,,	,, Balance c/d	17,112	10	–
		£18,500	–	–			£18,500	–	–
3	To Balance b/d	17,112	10	–	3	By Profit and Loss A/c ($7\frac{1}{2}$% on £17,112 10s.)	1,283	8	9
					,,	,, Balance c/d	15,829	1	3
		£17,112	10	–			£17,112	10	–
4	To Balance b/d	15,829	1	3					

The Annuity System.

By this method it is assumed that the capital sunk in the purchase of the asset might, if otherwise invested, have yielded a certain rate of interest. An equal instalment which, with interest charged on the diminishing value of the asset, will be sufficient to write off the value over its life, is charged every year as depreciation and credited to the asset account, which is debited with the interest.

The annual amount of depreciation remains constant, but the net charge to profit and loss increases, which is due to the fact that every year sees a reduction in the amount of interest based on the diminished value of the asset. The depreciation is calculated by means of tables.

EXAMPLE 2. A lease valued at £1,000 expires ten years hence. Show the Lease Account, after charging interest at 5 per cent and allowing an annual charge for depreciation of £129 10s., as it would appear in the books for the first four years of the life of the asset.

Dr. LEASE ACCOUNT *Cr.*

Year		£ s. d.	Year		£ s. d.
1	To Cash . .	1,000 – –	1	By Profit and Loss Account .	129 10 –
,,	,, Interest at 5% .	50 – –	,,	,, Balance c/d .	920 10 –
		£1,050 – –			£1,050 – –
2	To Balance b/d .	920 10 –	2	By Profit and Loss Account .	129 10 –
,,	,, Interest at 5% .	46 – 6	,,	,, Balance c/d .	837 – 6
		£966 10 6			£966 10 6
3	To Balance b/d .	837 – 6	3	By Profit and Loss Account .	129 10 –
,,	,, Interest at 5% .	41 17 –	,,	,, Balance c/d .	749 7 6
		£878 17 6			£878 17 6
4	To Balance b/d .	749 7 6	4	By Profit and Loss Account .	129 10 –
,,	,, Interest at 5% .	37 9 5	,,	,, Balance c/d .	657 6 11
		£786 16 11			£786 16 11
5	To Balance b/d .	657 6 11			

It will be observed from the foregoing example that the net charge to the Profit and Loss Account increases as shown below.

Year		£	s.	d.	£	s.	d
1.	Depreciation debited to P. & L. Account	129	10	–			
	Interest credited ,, ,, ,,	50	–	–			
	The net charge is . . .				79	10	–
2.	Depreciation debited to P. & L. Account	129	10	–			
	Interest credited ,, ,, ,,	46	–	6			
	The net charge is . . .				83	9	6
3.	Depreciation debited to P. & L. Account	129	10	–			
	Interest credited ,, ,, ,,	41	17	–			
	The net charge is . . .				87	13	–
4.	Depreciation debited to P. & L. Account	129	10	–			
	Interest credited ,, ,, ,,	37	9	5			
	The net charge is . . .				92	–	7

Depreciation Sinking Fund.

This method is adopted where it is decided not merely to reduce the asset in the books, but to set aside a sum from which the asset can be replaced when it is no longer of any useful value. A fixed sum is debited each year to the Profit and Loss Account and credited to a Sinking Fund Account. Cash is withdrawn and invested in gilt-edged or other securities, the interest thereon being credited to the Fund Account and invested with the next annual instalment.

The asset, therefore, appears in the books at its original cost, while the Fund Account is shown as a liability and the Investment Account as an asset. The chief advantage of this method is that investments are held equal to the estimated loss caused by depreciation, so that the cost of any replacement necessary can be met from the proceeds realized when the investments are sold.

For an explanation of the entries necessary, the reader is referred to the latter part of this chapter dealing with Sinking Funds.

Endowment Insurance Policy.

In effect, this is similar to the Sinking Fund method, the only difference being the investment of the yearly charge for depreciation. Instead of purchasing securities, the annual sum set aside is used to purchase an insurance policy. Whilst the yield may be smaller than that received from other forms of investment, the amount to be ultimately obtained on the maturity of the policy is definitely known and any fear of loss on realization is thus minimized. When the premiums are paid the debit entry will be made in an Insurance Policy Account, the balance of which will appear as an asset in the Balance Sheet. The profit and loss charge is credited to a Redemption Account which is shown in the Balance Sheet amongst the liabilities, and, as cash is withdrawn equal to the profit and loss provision, the totals of the Redemption and Policy Accounts will be the same. When the policy matures, adjustment must be made for interest allowed by the insurance company on the premiums paid, and to effect this, the Redemption Account is credited and the Policy Account debited with the interest. The Redemption Account is closed by transfer to the account of the asset to be replaced.

Assuming, for the purpose of example, that an annual premium of £250 is required to assure the payment of £1,100 in four years' time, from which a lease of that value can be renewed, the entries every year will be—

			£	£
	Insurance Policy Account . *Dr.* To Cash		250	 250
	Profit and Loss Account . *Dr.* To Lease Redemption Account .		250	 250

The first of the above entries represents the payment of the premium, and the second the annual amount chargeable against the profits for the purpose of lease redemption. At the end of the third year, the Balance Sheet entries will be:

BALANCE SHEET

Liabilities	£	*Assets*	£
Lease Redemption A/c .	750	Lease	1,100
		Insurance Policy A/c .	750

When the policy matures, any interest will be adjusted in the following manner—

		£	£
Insurance Policy Account . .	*Dr.*	100	
To Lease Redemption Account .			100

At the end of the four years, the Ledger Accounts will appear as follows—

Dr. LEASE ACCOUNT *Cr.*

Year			£	Year			£
1	To Cash . . .		1,100	4	By Lease Redemption Account . . .		1,100

Dr. INSURANCE POLICY ACCOUNT *Cr.*

Year			£	Year			£
1	To Cash (Premium) .		250				
2	,, ,, . . .		250				
3	,, ,, . . .		250				
4	,, ,, . . .		250				
,,	,, Lease Redemption Account . . .		100	4	By Cash . . .		1,100
			£1,100				£1,100

Dr. LEASE REDEMPTION ACCOUNT *Cr.*

Year			£	Year			£
				1	By Profit and Loss A/c .		250
				2	,, ,, ,, ,, .		250
				3	,, ,, ,, ,, .		250
				4	,, ,, ,, ,, .		250
4	To Lease Account . .		1,100	,,	,, Insurance Policy A/c .		100
			£1,100				£1,100

As will be observed, the Lease Account is closed by transfer from the Redemption Account, and when cash is received from the insurance company, a new lease can be purchased or the old one renewed.

Revaluation of Assets.

There are certain types of assets, the depreciation of which cannot be accurately estimated by any fixed method. These assets include loose tools, horses, harness, cattle, etc., and, since the value of such assets is constantly changing, it is necessary to arrive at a revaluation at the close of each trading period. Losses ascertained in this way are debited to the Profit and Loss Account and credited to the asset accounts concerned. The chief argument against this method is that whilst unequal charges are made for depreciation, the assets render virtually the same service each year.

RESERVES

Before discussing those reserves which represent huge accumulations of undivided profit, something should be said of the difference between this type of reserves and those discussed in Chapter II under profit and loss adjustments. The latter constitute a charge *against* revenue irrespective of whether the Profit and Loss Account shows a debit or credit balance, and represent a known loss or a contingent liability, typical examples being reserves for accruing rent and rates; reserves for bad and doubtful debts, and discounts. The reserve with which it is now proposed to deal is not a charge against profit, but is an *appropriation* out of profit, so that its creation and growth are dependent on profit first being made.

Reserve Fund.

A reserve fund is one made up of various appropriations of profit and, in its ideal state, is represented by easily realizable securities of a gilt-edged nature. The term "ideal" is used because in many cases the reserve is represented by assets which would not permit, in time of exigency, the fulfilment of the object for which it was created. The ostensible purpose of a reserve fund is to provide against unknown contingencies and to properly do this it is advisable that such a reserve

in five years' time. It is calculated from tables that, invested at 4 per cent, an annual sum of £923 2s. 9d. must be set aside for this purpose. Show the accounts of the company for these five years.

Dr. SINKING FUND INVESTMENT ACCOUNT *Cr.*

		£ s. d.			£ s. d.
Year 1 Dec. 31	To Cash . .	923 2 9	Year 1 Dec. 31	By Balance c/d .	923 2 9
Year 2 Jan. 1	To Balance b/d .	923 2 9	Year 2		
Dec. 31	,, Cash . .	960 1 2	Dec. 31	By Balance c/d .	1,883 3 11
		£1,883 3 11			£1,883 3 11
Year 3 Jan. 1	To Balance b/d .	1,883 3 11	Year 3		
Dec. 31	,, Cash . .	998 9 2	Dec. 31	By Balance c/d .	2,881 13 1
		£2,881 13 1			£2,881 13 1
Year 4 Jan. 1	To Balance b/d .	2,881 13 1	Year 4		
Dec. 31	,, Cash . .	1,038 8 3	Dec. 31	By Balance c/d .	3,920 1 4
		£3,920 1 4			£3,920 1 4
Year 5 Jan. 1	To Balance b/d .	3,920 1 4	Year 5 Dec. 31	By Cash (proceeds of sale)	
Dec. 31	,, Cash[1] . .	1,079 18 8			5,000 – –
		£5,000 – –			£5,000 – –

[1] The cash instalment at the end of the fifth year will not be invested, it being transferred to the Investment Account.

The result of these entries is that after the liability has been redeemed, there remains a balance in the Sinking Fund which represents a general reserve accumulated out of divisible profits. (In the example below, it will be seen that the Sinking Fund Account has been closed by transfer to reserve.) To illustrate this a little more clearly, take the case of a concern which, having issued debentures to the value of £10,000, repayable at the end of ten years, decides to provide for the repayment of this debt by means of a sinking fund. At the beginning of this period, the Balance Sheet would have the following appearance.

BALANCE SHEET (*a*)

Liabilities	£	*Assets*	£
Capital	25,000	General Assets . .	35,000
Debentures . . .	10,000		
	£35,000		£35,000

At the end of ten years, and before the repayment of the debentures, the Balance Sheet will show the accumulation of the Sinking Fund and its corresponding investments as follows—

BALANCE SHEET (*b*)

Liabilities	£	*Assets*	£
Capital	25,000	General Assets . .	35,000
Debentures . . .	10,000	Sinking Fund Investments . . .	10,000
Sinking Fund . .	10,000		
	£45,000		£45,000

Assuming that the investments realize their cost exactly, and that payment has been made to the debenture-holders, the Balance Sheet would then appear thus—

BALANCE SHEET (*c*)

Liabilities	£	*Assets*	£
Capital	25,000	General Assets . .	35,000
General Reserve . .	10,000		
	£35,000		£35,000

It will be observed that Balance Sheets (*a*) and (*c*) are almost identical, the only difference being that the liability to the debenture-holders is substituted by a general reserve representing undivided profits. Thus, the shareholders now have £35,000 invested in the business instead of £25,000.

In the foregoing illustrations it has been assumed, for the sake of clearness, that the investments of the Sinking Fund

B. By what method would you recommend provision be made for waste or wear and tear of the following assets—

(*a*) Fixed Plant and Machinery.
(*b*) Leaseholds.
(*c*) Loose Tools.
(*d*) Patents.

C. The following items appear among the assets in the Balance Sheet of a manufacturing concern—

(*a*) Goodwill at cost, less amounts written off, £18,000.
(*b*) Plant and Machinery at cost, less depreciation, £35,000.
(*c*) Stock in trade, at the lower of cost or market price, £21,395.

Explain the principles underlying the method of stating the values of each of the assets, showing why "fixed" assets usually receive different treatment to "floating" assets. Would you justify Plant and Machinery appearing in the Balance Sheet at a figure in excess of its market value, if so, when and why? (C.A.A.)

D. A company having a Lease standing in their books at £5,000, decide to provide for depreciation by taking out a policy for leasehold redemption. How would you deal with the annual premiums in the books; and how would you adjust the accounts when the Lease expires and the policy matures. (R.S.A.)

E. State briefly the facts that would guide you in arriving at the proper amount of depreciation to provide for upon Machinery and Plant used in a manufacturing business; and set out the entries you would pass through the books to give effect to the decision arrived at. (L.C.C.)

F. Give illustrations of Reserves, (*a*) out of profits, (*b*) against profits. (C.A.A.)

G. What is the difference between a "Reserve" and a "Reserve Fund"? (C.R.A.)

H. Should the yearly amounts appropriated to reserve be retained in the business? Give the advantages and disadvantages of this practice.

I. What is a Sinking Fund? State briefly the difference between the sinking fund to replace a wasting asset, and the sinking fund to redeem a liability.

J. What is a "Secret Reserve"? Give two examples showing how a bank, or other "financial house," could create a "Secret Reserve." (R.S.A.)

K. To what extent do you consider the creation or maintenance of "Secret Reserves" to be justifiable? (C.R.A.)

CHAPTER IV

THE ACCOUNTS OF PARTNERSHIPS

A PARTNERSHIP, which is defined by the Partnership Act, 1890, as "the relation which subsists between persons carrying on a business in common with a view to profit," implies a continuous association of persons, and the transactions of parties to a temporary venture or undertaking would not, therefore, come within the meaning of a "partnership." In addition, there are several other classes of transactions very much akin to, but outside, partnership relation, but, since the concern of this chapter is with the accounts of a definite partnership, it is not possible to go very deeply into those circumstances or conditions which determine whether or not partnership relation exists. And, for a similar reason, only those parts of the legal position which deal with the preparation of accounts will be discussed.

If an analysis is made of the above definition, it will be seen that before a partnership can exist in the eyes of the law, three conditions must be satisfied: there must be (1) a business, (2) carried on with a view to profit, and (3) by or on behalf of the alleged partners. As to what constitutes a "business" is a controversial matter. The Partnership Act describes it as "every trade, occupation or profession," but this must not be taken too literally, as it would not apply to the profession of a barrister, in which partnership is forbidden. It would seem for the purpose of partnership that the "business" is that recognized generally as a commercial or professional business.

The sharing of profit means *net* profit. Participation in gross receipts, e.g. in the case of an author, does not in itself constitute partnership. The real test of partnership relation is based on the intention and contract of the parties. And, furthermore, the business must be carried on by some or all of the partners for the good of all of them.

It is usual to formulate a deed or agreement determining the rights and duties of each partner and this may be (1) written, or (2) verbal, and if verbal, then either express or implied from events which follow the commencement of business. The terms of a written agreement may even be varied by implication from a course of dealing or series of events which differ therefrom. For instance, an agreement in writing may provide that profits and losses be equally shared, but, if the partners subsequently form the habit of dividing the profits in some other proportion, it will be implied that the written agreement has been varied by the common consent of the partners.

The law governing partnership transactions is to be found in the Partnership Act, 1890 and the Limited Partnership Act, 1907.

Classification of Partners.

No partnership can consist of more than twenty partners, or, in the case of a banking business, more than ten. For book-keeping purposes, there are two classes of partners, (*a*) general and (*b*) limited.

(*a*) A general partner is one who is permitted to take part in the conduct of the business and who is liable to the full value of his personal estate for partnership debts. General partners may be divided into—

(i) *Active.* Those who take part in the management of the business generally;

(ii) *Sleeping* or *dormant.* Those who take no active part in partnership affairs, and

(iii) *Nominal* or *ostensible.* Those who, not actually members of the firm, create the impression by their conduct that they are partners.

(*b*) A limited partner is one whose actions are restricted by law. He cannot withdraw any of his capital nor take part in the management of the business; he cannot dissolve the partnership by giving notice, and other partners may be introduced without his consent. The limited partner is, however, liable for the partnership debts only up to the amount

of capital he originally agrees to contribute, unless he violates any of the foregoing rules. A limited partnership must consist of both limited and general partners.

The Partnership Agreement.

The usual points which should be considered in this agreement are—

1. The capital of each partner and the rate of interest (if any) to be allowed on capital.
2. The division of profits and losses.
3. The amount each partner may withdraw in anticipation of profit and the interest (if any) to be charged on such drawings.
4. Partnership salaries (if any).
5. The term of the partnership or, if for an undefined time, the circumstances which shall cause the partnership to be dissolved.
6. The arrangements as to the business in case of the retirement or death of a partner and the treatment of goodwill on dissolution.
7. The conditions governing the introduction of new partners.
8. The settlement of disputes.

Although the need for a written agreement is obvious, Section 24 of the Partnership Act, 1890, sets out the rights and duties of partners which, in the absence of special agreement, or where such agreement does not operate, apply—

(1) All the partners are entitled to share equally in the capital and profits of the business, and must contribute equally towards the losses whether of capital or otherwise sustained by the firm.

(2) The firm must indemnify every partner in respect of payments and personal liabilities incurred by him—

(*a*) In the ordinary and proper conduct of the business of the firm; or

(*b*) In or about anything necessarily done for the preservation of the business or property of the firm.

(3) A partner making, for the purpose of the partnership, any actual payment or advance beyond the amount of capital which he has agreed to subscribe, is entitled to interest at the rate of 5 per cent per annum from the date of the payment or advance.

(4) A partner is not entitled, before the ascertainment of profits, to interest on the capital subscribed by him.

(5) Every partner may take part in the management of the partnership business.

(6) No partner shall be entitled to remuneration for acting in the partnership business.

(7) No person may be introduced as a partner without the consent of all existing partners.

(8) Any difference arising as to ordinary matters connected with the partnership business may be decided by a majority of the partners, but no change may be made in the nature of the partnership business without the consent of all existing partners.

(9) The partnership books are to be kept at the place of business of the partnership (or the principal place, if there is more than one), and every partner may, when he thinks fit, have access to and inspect and copy any of them.

Many of the foregoing provisions have a great effect on the accounts of a partnership, and it would, therefore, seem advisable at this juncture to deal in detail with those points which really constitute the main difference between the partnership and the sole trader, as far as the accounts are concerned.

Partners' Capital.

A separate account is kept for each partner, which is credited with the amount of capital he agrees to subscribe. The corresponding debit entry will appear in the Cash Book if cash is introduced or, if an asset other than cash is brought in, such as machinery, fixtures, etc., a special account opened for this will be debited with the value of the asset introduced. The partner's Capital Account will also be credited with interest on capital and with his share of the profits. When drawings are permitted, these will be debited to the Capital Account from time to time. After the Profit and Loss Account has been prepared and the balance of net profit computed, these capital accounts will be closed in the usual way and the balances brought down; a credit balance representing the partner's capital at the commencement of the new period, a deficiency or debit balance indicating that drawings and/or share of loss have exceeded his capital.

It is not unusual for the partnership agreement to stipulate that the capital of the partners shall remain fixed, in which case it will be necessary to open subsidiary or current accounts to record such items as interest on capital, drawings, and share of profit (or loss). The balance of these accounts will appear separately in the Balance Sheet.

Partners' Loans.

Advances made by way of loan are credited, not to the partner's Capital Account, but to a Loan Account. Interest thereon is debited to Profit and Loss, and credited to the Loan Account. The balance of this account should be kept apart from those of the capital accounts because, in the event of dissolution, repayment of any loan is made prior to that of capital.

Partners' Salaries.

Where one of the partners takes a larger share in the management of the business than his colleagues, provision is sometimes made in the partnership agreement for the payment of a salary in addition to a share of the profit. Cash will be credited when payment is made and a Partners' Salary Account debited, the balance of which is subsequently transferred to the Profit and Loss Account. When cash is not withdrawn, the Capital or Current Account instead of the Cash Book is credited with the salary.

Partners' Drawings.

Drawings made by partners from time to time, whether on account of profit or salary, are debited to the Capital or Current Account of each partner. Although quite unnecessary, it is sometimes the practice to open separate accounts for drawings, and if this is done the balances of these accounts are transferred, at the year end, to the Capital or Current Accounts. Drawings do not constitute a charge against profit, and, for this reason, should *not* appear in the Profit and Loss Account. If interest on Drawings is to be charged, this, when

capital of £3,000. Give the Journal entries, which are necessary to record this transaction in the partnership books.

JOURNAL

				£	£
	Cash . . . . . . *Dr.* To Hood's Capital Account . ,, Brown's ,, ,, . Being division of premium paid by Smith between the old partners.			1,000	 625 375
	Hood's Capital Account . *Dr.* Brown's ,, ,, . *Dr.* To Cash . . . . . Being the withdrawal of above premium in accordance with agreement.			625 375	 1,000
	Cash . . . . . . *Dr.* To Smith's Capital Account . Being capital introduced by Smith on his admission to partnership.			3,000	 3,000

Where interest on capital is allowed, it will be noticed that in the first two examples the incoming partner is further penalized because the old partners' Capital Accounts are increased by the amount of the premium (or goodwill), and thus the amount of interest they will receive is correspondingly increased. Moreover, as interest on capital is charged before the apportionment of profit, it is obvious that the net amount ultimately to be divided will be reduced by the amount of the "extra" interest.

Revaluation of Assets.

The admission of a new partner frequently involves a readjustment of the book values of assets. Although the balance sheet values of assets should be as near as possible to their true values this, in practice, is not always the case, and it may, therefore, be necessary for a revaluation to be made prior to the new partner's admittance. Adjustment is made by means of Journal entries, the asset accounts being debited with any increase in value and credited with any decrease,

the contra entries appearing in the capital accounts of the partners. The net "profit" or "loss" on revaluation is borne in the proportion to which trading profit or loss is shared.

EXAMPLE 5. Baker and Tyler are partners in a business sharing profits and losses equally. On 31st December their Balance Sheet showed the following position—

BALANCE SHEET

Liabilities	£	*Assets*	£
Creditors . . .	7,000	Cash	3,000
Capital Accounts—		Debtors . . .	4,500
Baker . . .	10,000	Stock	8,500
Tyler . . .	9,500	Plant	5,500
		Fixtures . . .	1,000
		Premises . . .	4,000
	£26,500		£26,500

They agree to admit into partnership Macey as from 1st January on the undermentioned terms—

1. Macey to introduce £5,000 as capital and to pay a premium of £5,000 to be retained in the business.

JOURNAL

19..			£	£
Jan. 1	Cash . . . . . . *Dr.*		5,000	
	To Baker's Capital Account .			2,500
	,, Tyler's ,, ,, .			2,500
	Being division of premium paid by Macey between the old partners.			
	Cash . . . . . . *Dr.*		5,000	
	To Macey's Capital Account .			5,000
	Being capital introduced by Macey in accordance with agreement.			
	Baker's Capital Account . *Dr.*		725	
	Tyler's ,, ,, . *Dr.*		725	
	To Stock			850
	,, Plant			275
	,, Fixtures			100
	,, Bad Debts Reserve . .			225
	Being revaluation of asset values on introduction of Macey into partnership.			

2. The existing values of assets to be adjusted thus: Stock to be reduced 10 per cent. Plant reduced 5 per cent. Fixtures reduced 10 per cent, and a reserve of 5 per cent to be made on the Debtors for bad debts.

Make the necessary entries in the Journal and Cash Book to carry out the above agreement. Write up the partners' Capital Accounts and show the Balance Sheet of the new firm prior to commencing business.

Dr. CASH BOOK *Cr.*

			£				£
19.. Dec. 31	To Balance		3,000	19..			
19.. Jan. 1	„ Capital A/cs—						
	Baker		2,500				
	Tyler		2,500				
	Macey		5,000				

Dr. BAKER'S CAPITAL ACCOUNT *Cr.*

			£				£
19.. Jan. 1	To Sundries		725	19.. Dec. 31	By Balance		10,000
				19.. Jan. 1	„ Cash		2,500

Dr. TYLER'S CAPITAL ACCOUNT *Cr.*

			£				£
19.. Jan. 1	To Sundries		725	19.. Dec. 31	By Balance		9,500
				19.. Jan. 1	„ Cash		2,500

Dr. MACEY'S CAPITAL ACCOUNT *Cr.*

			£				£
19..				19.. Jan. 1	By Cash		5,000

BAKER, TYLER & MACEY
BALANCE SHEET AS AT 1ST JANUARY, 19..

Liabilities	£	*Assets*	£
Creditors	7,000	Cash	13,000
		Debtors (*less* Reserve for Bad Debts	4,275
Capital Accounts—		Stock	7,650
Baker	11,775	Plant	5,225
Tyler	11,275	Fixtures	900
Macey	5,000	Premises	4,000
	£35,050		£35,050

Retirement of a Partner.

When a partner retires it is necessary to determine the amount of his capital in the business together with any accrued profits. The last Balance Sheet, prior to retirement, where this takes place between two trading periods, is generally accepted as a basis, but to this must be added the retiring partner's share of the goodwill (if any).

The entries to be made when the final balance has been calculated vary with the terms of repayment. If the retiring partner's share is paid at once, the Cash Book is credited, and the retiring partner's Capital Account debited and closed. Prior to this, any balance standing to the credit of his Current Account and his share of the goodwill is transferred to the retiring partner's Capital Account.

The risk of loss on the sudden disposal of assets, should this be necessary, may cause repayment to be made by means of a number of instalments. If this plan is agreed to, the retiring partner's Capital Account is closed by a debit entry, and a Loan Account is credited with its balance and any interest subsequently chargeable on the balance outstanding. The Cash Book will be credited, and the Loan Account debited with the instalment when paid, any balance remaining in the latter account appearing in the Balance Sheet as a liability.

EXAMPLE 6. X, Y, and Z are in partnership sharing profits and losses in equal proportions. Z decides to retire as from 31st December, at which date the Balance Sheet of the partnership revealed the following position—

BALANCE SHEET

Liabilities	£	*Assets*	£
Creditors	5,000	Cash	3,500
Current Accounts—		Debtors	5,600
X	1,050	Stock	7,900
Y	1,150	Fixtures	2,500
Z	1,800	Premises	5,000
Capital Accounts—			
X	5,500		
Y	5,500		
Z	4,500		
	£24,500		£24,500

The partnership agreement provides that in the event of a partner retiring, the goodwill of the business is to be valued at the average yearly profit of the three years immediately preceding retirement. These profits were £4,890, £2,765, and £3,820. Ascertain the amount due to Z, transfer this to a Loan Account and give the opening Balance Sheet of X and Y, assuming that their Capital Accounts are to remain fixed.

Goodwill is arrived at thus—

$$£\frac{4{,}890+2{,}765+3{,}820}{3} = £\frac{11{,}475}{3} = £3{,}825$$

Z's share is, therefore, one-third of £3,825 or £1,275.

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			£	£
	Goodwill Account . . *Dr.*		1,275	
	To Z Loan Account . . .			1,275
	Being Z's share of Goodwill.			
	Z Capital Account . . *Dr.*		4,500	
	Z Current Account . . *Dr.*		1,800	
	To Z Loan Account . . .			6,300
	Being balances of Z's Capital and Current Accounts transferred to Z's Loan Account.			

Dr. Z—LOAN ACCOUNT *Cr.*

						£
				By Goodwill Account		1,275
				,, Capital Account .		4,500
				,, Current Account .		1,800

X & Y

BALANCE SHEET AS AT 1ST JANUARY, 19..

Liabilities	£	*Assets*	£
Creditors	5,000	Cash	3,500
Z's Loan Account . .	7,575	Debtors	5,600
Current Accounts—		Stock	7,900
X	1,050	Fixtures	2,500
Y	1,150	Premises	5,000
Capital Accounts—		Goodwill	1,275
X	5,500		
Y	5,500		
	£25,775		£25,775

Where the Capital Accounts of the surviving partners are not fixed and are increased as a result of the creation of goodwill, the opening Balance Sheet would appear as follows—

X & Y

BALANCE SHEET AS AT 1ST JANUARY, 19..

Liabilities	£	*Assets*	£
Creditors	5,000	Cash	3,500
Z's Loan Account	7,575	Debtors	5,600
Current Accounts—		Stock	7,900
X	1,050	Fixtures	2,500
Y	1,150	Premises	5,000
Capital Accounts—		Goodwill	3,825
X[1]	6,775		
Y[1]	6,775		
	£28,325		£28,325

[1] These amounts include the share of Goodwill as computed on the previous page, the Goodwill Account and the totals of the Balance Sheet being correspondingly increased.

Death of Partner.

In the absence of agreement to the contrary, the death of a partner will automatically dissolve the partnership, but it is usual, wherever possible, for the surviving partners to carry on the business. The reason for this is obvious. To dispose of the business at once may mean heavy financial loss, and to avoid this it is essential that the business be carried on for at least some little time after a partner's demise. So that where full settlement is likely to prove detrimental to the business, particularly to the late partner's share therein, an arrangement is made similar to that outlined in the case of a partner's retirement, whereby repayment is carried out by means of instalments.

The last Balance Sheet prepared prior to the partner's decease will again serve as a suitable basis on which the value of his share can be calculated, but to the figure ultimately agreed must be added his share of (*a*) accrued profits, (*b*) goodwill, and (*c*) interest from the date of death. With reference to the last item, the deceased partner's representatives may claim, unless agreement otherwise stipulates, interest at 5 per

cent per annum on the ascertained value of his share. When the total of this share has been calculated it is transferred to an account headed "Personal Representatives of —— (deceased)." When payment is made, the Cash Book is credited and the Representatives' Account debited with the amount of the instalment. The Representatives' Account will, of course, be credited from time to time with interest on the balance outstanding.

EXAMPLE 7. A, B, and C are in partnership sharing profits and losses in the proportion of three-sixths, two-sixths, and one-sixth respectively. At the 31st December, 19.., the Balance Sheet of the firm showed the following position—

Liabilities	£	*Assets*	£
Creditors	3,500	Sundry Assets	13,100
Capital Accounts—		Goodwill	1,400
A	5,000		
B	4,000		
C	2,000		
	£14,500		£14,500

According to the partnership deed, 5 per cent interest was payable on capital. A died in June. It was agreed that the sum of £1,475 be granted to his personal representatives in lieu of profit accrued, and that from the date of death interest at the rate of 6 per cent should be allowed on the balance due in respect of his total share. Prepare an account showing the amount due to A's representatives at 31st December following death, assuming that the amount of £2,500 was paid to the representatives immediately after his death. (See next page.)

To avoid the possibility of difficulty and loss, which can easily arise on those occasions upon which a partner dies, it is sometimes preferable for the partnership to take out an insurance policy which matures on the death of one of the partners of the firm. The premiums of this policy constitute a charge against profit, and upon maturity the insurance money is divided in the same way as ordinary trading profits.

THE PERSONAL REPRESENTATIVES OF A (Deceased)

Dr. | | | *Cr.*

19..		£	19..		£
June —	To Cash	2,500	June —	By Capital Account	5,000
				,, Accrued Profit	1,475
				,, Share of Goodwill	700
			Dec. 31	,, Interest on Capital for six months at 5% per annum	125
				,, Interest on Balance £4,800 at 6% per annum for six months	144
Dec. 31	,, Balance c/d	4,944			
		£7,444			£7,444
			Dec. 31	By Balance b/d	4,944

Dissolution.

Apart from the terms of any agreement, the occurrence of any event which makes it unlawful for the partners to carry on business will dissolve the partnership. In addition to this, but subject to provision to the contrary in any agreement, a partnership is dissolved—

1. By effluxion of time, if entered into for a fixed period.
2. If entered for a single venture, by its accomplishment.
3. By notice of any of the partners; if partnership is for an undefined time, i.e. a partnership at will.
4. By death or bankruptcy of a partner.
5. At the option of the other partners where one partner has permitted his share in the business to be charged for his separate debt.

The Court may, on application, decree a dissolution where—

(*a*) A partner becomes incapacitated, mentally or otherwise, and, as a result, cannot properly act or take part in the management;

(*b*) A partner has been guilty of conduct calculated to prejudice the business of the firm, e.g. being convicted for a criminal offence;

(*c*) A partner is guilty of wilful misconduct, e.g. persistent breach of agreement;

(*d*) The business can be carried on only at a loss, and

(*e*) In the opinion of the Court it is just and equitable that dissolution should be made.

Dissolution may also occur as a result of: (i) Mutual consent among partners to dissolve and dispose of the business; (ii) the conversion of the partnership into or sale to a limited company, and (iii) insolvency of the partnership.

The terms according to which dissolution is carried out and the manner in which the proceeds from the realization of assets are distributed will naturally vary in accordance with the terms of any agreement. But, since no agreement can alter their rights as a partnership to the creditors of the firm, the partners are to some extent bound by Section 44 of the Partnership Act, which reads as follows—

In settling accounts between partners after a dissolution of partnership, the following rules shall, subject to any agreement, be observed—

(*a*) Losses, including losses and deficiencies of capital, shall be paid first out of profits, next out of capital, and lastly, if necessary, by the partners individually in the proportion in which they are entitled to share profits.

(*b*) The assets of the firm, including the sums, if any, contributed by the partners to make up losses or deficiencies of capital, shall be applied in the following manner and order—

1. In paying the debts and liabilities of the firm to persons who are not partners therein.
2. In paying to each partner rateably what is due from the firm to him for advances as distinguished from capital.
3. In paying to each partner rateably what is due from the firm to him in respect of capital.
4. The ultimate residue, if any, shall be divided among the partners in the proportion in which profits are divisible.

Dissolution, therefore, presupposes the sale of assets, the satisfaction of creditors, and the repayment of partners' loans and capitals. To calculate the profit or loss made on realization, a special account is opened in the books called a Realization Account and the procedure which then has to be adopted is as follows—

1. Close all asset accounts, excepting Cash, by posting the balances to the debit side of the Realization Account.
2. When the assets are sold, debit the Cash Book and credit Realization Account with the amount realized.

3. Debit Realization Account and credit Cash Book with costs of realization.

4. Credit the Cash Book and debit the individual accounts when payment is made to creditors. Allowances made by creditors are credited to the Realization Account.

5. Total the Realization Account, transferring the balance to the capital accounts of the partners in the proportions in which profit or loss is divided. Should one of these capital accounts show a *debit* balance, i.e. where the partner's share of the loss on realization exceeds the amount of his capital, the partner concerned must bring in *cash* equal to his deficiency, the Cash Book being debited and the Capital Account credited with the cash brought in.

6. The balance of the Cash Book should now exactly equal the combined credit balances of the partners' accounts, and this must be applied in repayment of (1) partners' loans, and (2) partners' capitals.

EXAMPLE 8. Black and White are in partnership, sharing profits and losses two-thirds and one-third respectively. They decide to dissolve partnership on 30th June, 19.., at which date their Balance Sheet revealed the following—

BALANCE SHEET

Liabilities	£	*Assets*	£
Creditors . . .	3,750	Cash	500
Capital Accounts—		Debtors . . .	2,750
Black . . .	4,500	Stock	6,500
White . . .	3,000	Fixtures . . .	1,500
	£11,250		£11,250

The assets on sale realized £12,000, and the costs of realization amounted to £200. Close the books of the partnership, showing the Ledger Accounts.

Dr. REALIZATION ACCOUNT *Cr.*

		£			£
✓	To Sundry Assets .	10,750	✓	By Cash . . .	12,000
✓	,, Cash (Expenses) .	200			
	,, Profit c/d . .	1,050			
		£12,000			£12,000
	To Capital A/cs—			By Profit b/d . .	1,050
	Black . .	700			
	White . .	350			
		£1,050			£1,050

Dr. CASH BOOK *Cr.*

		£			£
✓	To Balance . .	500	✓	By Realization A/c (Expenses) .	200
✓	,, Realization A/c (proceeds of sale)	12,000	✓	,, Creditors . .	3,750
				,, Capital A/cs—	
				Black . .	5,200
				White . .	3,350
		£12,500			£12,500

Dr. BLACK—CAPITAL ACCOUNT *Cr.*

		£			£
	To Cash . . .	5,200		By Balance . .	4,500
				,, Realization A/c .	700
		£5,200			£5,200

Dr. WHITE—CAPITAL ACCOUNT *Cr.*

		£			£
	To Cash . . .	3,350		By Balance . .	3,000
				,, Realization A/c .	350
		£3,350			£3,350

EXAMPLE 9. Elliott and Hall in equal partnership agree to dissolve on the 31st March, 19... The Balance Sheet of the firm at this date was as follows—

BALANCE SHEET

Liabilities	£	*Assets*	£
Creditors	3,350	Cash	535
Elliott (Loan) . .	750	Debtors	4,200
Capital Accounts—		Stock	7,600
Elliott . . .	6,000	Furniture	640
Hall	5,875	Premises	3,000
	£15,975		£15,975

The assets, other than cash, realized £10,420, and the liquidation costs amounted to £178. Discount on creditors totalled £50. Close the books of the partnership and show the Ledger Accounts.

Dr. REALIZATION ACCOUNT *Cr.*

	£		£
To Sundry Assets .	15,440	By Cash . . .	10,420
,, Cash (Expenses) .	178	,, Discount on Creditors . .	50
		,, Balance—Loss on Realization c/d .	5,148
	£15,618		£15,618
To Balance b/d .	5,148	By Capital A/cs—	
		Elliott . .	2,574
		Hall . .	2,574
	£5,148		£5,148

Dr. CASH BOOK *Cr.*

	£		£
To Balance . .	535	By Realization A/c (Expenses) .	178
,, Realization A/c (proceeds of sale)	10,420	,, Creditors . .	3,300
		,, Elliott—Loan .	750
		,, Capital A/cs—	
		Elliott . .	3,426
		Hall . .	3,301
	£10,955		£10,955

Dr. CREDITORS *Cr.*

	£		£
To Realization A/c (Discount) .	50	By Balance . .	3,350
,, Cash . . .	3,300		
	£3,350		£3,350

Dr. ELLIOTT—LOAN ACCOUNT *Cr.*

	£		£
To Cash . . .	750	By Balance . .	750

Dr. ELLIOTT—CAPITAL ACCOUNT *Cr.*

		£			£
	To Realization A/c .	2,574		By Balance . .	6,000
	,, Cash . . .	3,426			
		£6,000			£6,000

Dr. HALL—CAPITAL ACCOUNT *Cr.*

		£			£
	To Realization A/c .	2,574		By Balance . .	5,875
	,, Cash . . .	3,301			
		£5,875			£5,875

Garner v. Murray (1904).

This legal decision applies to a case in which upon dissolution the capital account of one of the partners shows a *debit* balance after loss on realization has been charged thereto, and he is unable to make good his deficiency. It does not necessarily follow that the partnership itself is insolvent, as the capital accounts of the other partners may show substantial credit balances.

Prior to this decision, it was customary to treat the loss occasioned by the indebtedness of a partner as a *trading* loss, such loss being borne by the solvent partners in the proportion to which trading losses were borne. But the ruling in *Garner* v. *Murray* has altered this. The loss caused by the default of an insolvent partner is borne in proportion to *capital* and not in the proportion in which ordinary losses are shared. The correct application of this decision has caused considerable discussion amongst accountants, but it is generally thought that the true interpretation is for the partners to *contribute cash to meet their share of the loss on realization.* The debit balance on the insolvent partner's account is closed by transfer to the solvent partners' Capital Accounts. The available cash, after the creditors have been satisfied, is paid to each of the solvent partners according to the credit balance standing to his account. The following example clearly shows the application of the foregoing.

EXAMPLE 10. Lane, Smith, and Brown are equal partners whose Balance Sheet at 31st March, 19.., was as follows—

BALANCE SHEET

Liabilities	£	*Assets*	£
Creditors . . .	3,000	Plant	1,000
Lane—Loan . . .	2,000	Debtors . . .	3,500
Capital Accounts—		Stock	4,000
Lane . . .	5,000	Property . . .	1,500
Smith . . .	2,500	Capital Account—	
		Brown . . .	2,500
	£12,500		£12,500

They decide to dissolve partnership and upon sale the assets realize a total of £8,030, the costs of winding-up amounting to £430. Brown, being insolvent, was unable to bring in his share of the deficiency. Draw up a Realization Account and Cash Book and show the partners' Capital Accounts.

Dr. REALIZATION ACCOUNT *Cr.*

		£			£
	To Sundry Assets .	10,000		By Cash . . .	8,030
	,, Cash (Expenses) .	430		,, Balance—Loss on Realization c/d .	2,400
		£10,430			£10,430
	To Balance b/d .	2,400		By Capital A/cs—	
				Lane . .	800
				Smith . .	800
				Brown . .	800
		£2,400			£2,400

Dr. LANE—LOAN ACCOUNT *Cr.*

		£			£
	To Cash . . .	2,000		By Balance . .	2,000

Dr. LANE—CAPITAL ACCOUNT *Cr.*

		£			£
	To Realization A/c .	800		By Balance . .	5,000
	,, Share of Brown's deficiency . .	2,200		,, Cash (share of Realization loss)	800
	,, Cash . . .	2,800			
		£5,800			£5,800

Dr. SMITH—CAPITAL ACCOUNT *Cr.*

		£		£
To Realization A/c .		800	By Balance . .	2,500
,, Share of Brown's deficiency . .		1,100	,, Cash (share of Realization loss)	800
,, Cash . . .		1,400		
		£3,300		£3,300

Dr. BROWN—CAPITAL ACCOUNT *Cr.*

	£		£
To Balance . .	2,500	By Capital A/cs—	
,, Realization A/c .	800	Lane two-thirds.	2,200
		Smith one-third .	1,100
	£3,300		£3,300

Dr. CASH BOOK *Cr.*

	£		£
To Realization A/c (proceeds of sale)	8,030	By Realization A/c (Expenses) .	430
,, Capital Accounts (share of loss on realization)—		,, Creditors . .	3,000
		,, Lane—Loan .	2,000
		,, Capital A/cs—	
Lane . .	800	Lane . .	2,800
Smith . .	800	Smith . .	1,400
	£9,630		£9,630

The chief exception against the payment of cash by the solvent partners for the purpose of making good their share of the deficiency is that it is not rational to expect partners to bring in cash when they already have credit balances in their Capital Accounts and, furthermore, that it might be impossible since the partners concerned may have placed the whole of their possessions into the partnership. As far as the accounts are concerned, the only material alteration is that, instead of cash being introduced, the loss on realization is transferred to the Capital Accounts in the usual way, and the *final* cash repayment to the solvent partners is therefore reduced, since there is no cash equivalent to the realization loss on the opposite side. At first sight, this may appear confusing, but if, for illustration, the previous example is

taken, the Capital Accounts of Lane and Smith would, assuming no cash is brought in, have had the following appearance—

Dr. LANE—CAPITAL ACCOUNT *Cr.*

		£		£
	To Realization A/c .	800	By Balance . .	5,000
	,, Share of Brown's deficiency . .	2,200		
	,, Cash . . .	2,000		
		£5,000		£5,000

Dr. SMITH—CAPITAL ACCOUNT *Cr.*

		£			£
	To Realization A/c .	800		By Balance . .	2,500
	,, Share of Brown's deficiency . .	1,100			
	,, Cash . . .	600			
		£2,500			£2,500

and the Cash Book—

Dr. CASH BOOK *Cr.*

		£			£
	To Realization A/c (proceeds of sale)	8,030		By Realization A/c (Expenses) .	430
				,, Creditors . .	3,000
				,, Lane—Loan .	2,000
				,, Capital A/cs—	
				Lane . .	2,000
				Smith . .	600
		£8,030			£8,030

A comparison of the two examples will reveal at a glance what difference is made in the accounts where the solvent partners do not bring in cash equal to their shares of the loss on realization.

Conversion or Sale.

Where a partnership business is converted into, or sold to, a limited company, it becomes necessary to close all Ledger accounts at the date from which the conversion or sale is to commence. This is done in the same manner as that outlined for dissolution. The only difference arises where (*a*) part of the assets and/or liabilities are taken over by the new company

and (*b*) the purchase consideration is payable partly in cash and partly in fully-paid shares in the new concern.

EXAMPLE 11. Martin and Marshall are equal partners. They agree to convert their business into a limited company as and from 30th June, 19.., at which date their Balance Sheet revealed the following liabilities and assets—

BALANCE SHEET

Liabilities	£	*Assets*	£
Creditors . . .	7,500	Cash in Hand . .	80
Capital Accounts—		Cash at Bank . .	1,120
Martin . . .	6,000	Debtors . . .	5,300
Marshall . . .	6,000	Stock	8,000
		Plant	1,000
		Premises . . .	4,000
	£19,500		£19,500

By the terms of the conversion, the company is to take over all the assets (including Cash) and liabilities at Balance Sheet values, the purchase consideration being £16,000, payable in cash £6,000, the balance, in fully-paid shares. Prepare a Realization Account and show the partners' Capital Accounts after the above transactions have been carried out.

Dr. REALIZATION ACCOUNT *Cr.*

			£				£
	To Sundry Assets .		19,500		By Liabilities . .		7,500
	,, Balance—profit on Realization .		4,000		,, New Company .		16,000
			£23,500				£23,500
	To Capital A/cs—				By Balance b/d .		4,000
	Martin . .		2,000				
	Marshall . .		2,000				
			£4,000				£4,000

Dr. MARTIN—CAPITAL ACCOUNT *Cr.*

			£				£
	To Cash . . .		3,000		By Balance . .		6,000
	,, Shares . .		5,000		,, Realization A/c .		2,000
			£8,000				£8,000

Dr. MARSHALL—CAPITAL ACCOUNT *Cr.*

			£				£
	To Cash . . .		3,000		By Balance . .		6,000
	,, Shares . .		5,000		,, Realization A/c .		2,000
			£8,000				£8,000

EXERCISE IV

A. Name the important clauses you would expect to find in a Partnership Deed. (C.R.A.)

B. Jones, Smith, and Robinson are partners, their respective Capitals being £4,000, £2,000, and £1,000. In what proportions are they entitled to share profits, and at what rate per cent per annum, if any, are they entitled to interest on capital? (C.R.A.)

C. What is a sleeping partner, and to what extent is he liable for the debts of a firm? What do you understand by a partner by estoppel? (C.A.A.)

D. What are (*a*) the advantages, (*b*) the disadvantages to a limited partner in forming a partnership under the Limited Partnership Act? (C.R.A.)

E. On what grounds will the Court make an order dissolving the partnership? Enumerate the different ways in which a partnership may be dissolved. (C.R.A.)

F. In what order is the property of a firm distributed after dissolution, and what are the rights of the partners with regard to goodwill? (C.R.A.)

G. In a partnership where one partner has died, and the other partners continue to carry on the business with the deceased partner's capital, what are the rights of the deceased partner's representatives? (C.R.A.)

H. Jones and Robinson, partners, possess £30,000 and £7,500 in the firm of Jones and Robinson. By their partnership agreement they divide profits in proportion to their capitals after payment of £750 to Robinson as Manager and allowing 6 per cent interest on capital. Their gross trading profit is £5,000. Drawings—Jones, £200; Robinson, £150. Draw up separate Partners' Accounts. (C.R.A.)

I. Dot and Dash were partners in a trading concern, interest at 5 per cent per annum being allowed on their Capital Accounts, and the balance of profits being divisible in the ratio of 3 to 2. The firm's Balance Sheet as on 30th September, 19.., was as follows.

BALANCE SHEET

Liabilities	£	*Assets*	£
Capital—Dot	8,000	Lease	600
,, Dash	5,000	Stock	10,407
Creditors	3,192	Debtors	7,200
Bank Overdraft	2,074	Cash	59
	£18,266		£18,266

Blank was introduced as a partner on 1st October on the terms that he was to pay £3,000 for a one-fourth share of the Goodwill, and to bring in £2,000 as his capital. Prior to his coming in the Lease Account was to be written up to £1,800, and a reserve made equal to 5 per cent of the debtors. Dot and Dash were to draw out £1,000 and £500 respectively, the balance of their shares of the payment for Goodwill being left in the business as Capital. Blank was to receive a partnership salary of £200 per annum in consideration of putting in extra working time, and quarter of the balance of profits, while Dot and Dash (as between themselves) continued sharing profits in the same ratio as before.

The various payments, etc., having been made on the 1st October, you are required to draw up the opening Balance Sheet of the new firm. A profit of £8,230 having been made for the year ended 30th September, 19.. (i.e. the first trading year of the new partnership), before charging partnership interest or salary, show the division of the same between the partners.

(L.C.C.)

J. A and B are equal partners. Their Balance Sheet at the 31st December, 19.., is as follows—

BALANCE SHEET

Liabilities	£	*Assets*	£
Creditors	100	Properties	1,150
Bank Overdraft	1,000	Stock	500
Capital Accounts—		Debtors	700
A	1,000		
B	250		
	£2,350		£2,350

B agrees to provide a further £500 Capital on condition that the value of the Properties is reduced to £1,000. C joins them, bringing in £1,000 of which one-half is to be considered as goodwill and left in the business. This £1,000 is used to pay off the

Bank Overdraft. Show the opening Balance Sheet of A, B, and C after all arrangements have been completed.

(C.A.A.)

K. Hooper and Capel were partners sharing profits two-thirds and one-third respectively. Their Balance Sheet on the 31st December, 19.., was as follows—

BALANCE SHEET

Liabilities	£	*Assets*	£
Creditors . . .	200	Property . . .	2,600
Capital Accounts—		Debtors . . .	1,000
Hooper . . .	2,500	Cash	100
Capel . . .	1,000		
	£3,700		£3,700

They agreed to admit Lucas on the following terms—

1. To bring in £1,500 of which £600 was to be regarded as goodwill, to be left in the business.
2. Property to be written down by £200 and a Reserve of £100 for Bad Debts created.
3. Lucas's share to be one-third, and those of Hooper and Capel to bear the same relation to each other as heretofore.

Show the opening Balance Sheet of the new partnership, and indicate the respective shares of the three partners.

(I.B.)

L. "The Goodwill of the business is worth £5,000." What is meant by the above statement? X Y agreed to take A B into partnership. A B was to pay £1,500 by way of premium for admission as a partner, and was to bring in £3,000 cash into the business as his capital. Give the entries necessary to record the above particulars. (R.S.A.)

M. Beasley, Clark, and Herman are in partnership, sharing profits in the proportions of 4, 3, and 2. The deed of partnership provides, *inter alia*, that—

(*a*) Partners are entitled to interest on capital at the rate of 5 per cent per annum.

(*b*) In the event of a partner dying, the accounts shall be prepared as on the 31st December next following, and that his representatives shall be entitled to interest on capital and profits as though he had lived to that date.

(*c*) For the purpose of computing the deceased partner's share, Goodwill is to be valued at the average yearly profit for the last five years, including the year during which death took place.

(*d*) The total sum due to the deceased, as ascertained from the accounts, to be paid to his representatives within twelve months of death, with interest at the rate of 5 per cent per annum on any balance remaining unpaid from 31st December to date when payment is made.

To assist in finding the capital with which to pay the deceased partner's share, a life assurance policy for £5,000 had been taken out some years previously. Herman died on the 25th November. The accounts were duly prepared, and showed the capitals (which were unchanged during the year) of the partners as Beasley, £10,000; Clark, £8,000, and Herman, £7,000. The year's profit before charging interest on capital amounted to £5,615. Herman's drawings to date of death totalled £500. The firm's profit for the previous four years had been £4,817, £3,179, £6,280, and £7,549. The insurance company paid £5,000 on the 29th December, which was handed the same day to the deceased partner's representatives.

You are required to ascertain the balance to be paid over at the final settlement which was made on the 30th June following death.

N. Messrs. Black and White were equal partners in a retail boot shop. They decided to retire and dispose of their business as on 31st December. At the close of the year their Balance Sheet was as follows—

BALANCE SHEET

Liabilities	£	*Assets*	£
Capital Accounts—		Lease	1,250
Black	3,050	Fixtures	220
White	960	Sundry Debtors	840
Sundry Creditors	480	Stock	2,060
		Cash at Bank	120
	£4,490		£4,490

The Lease and Fixtures were disposed of for £2,700 and the cash duly received. The Book Debts were collected, and realized £752. The stock was sold by auction and produced £1,340 after payment of commission and expenses. The Sundry Creditors were paid off, £38 being allowed for discount. The expenses of realization amounted to £87. As book-keeper to the firm, prepare whatever accounts may be necessary to show the result of the realization and the amount receivable by each partner.

(L.C.C.)

O. A, B, and C are in partnership, sharing profits and losses one-half, three-tenths, and one-fifth respectively. Their Balance Sheet at 30th June, 19.., is as follows—

BALANCE SHEET

Liabilities	£	*Assets*	£
Capital Accounts—		Plant	3,000
A	4,000	Debtors	1,000
B	2,500	Stock	2,200
C	1,300	Cash	1,800
Creditors	200		
	£8,000		£8,000

They agree to dissolve partnership. A took over some of the Plant for £1,000, and the balance realized £1,200. B bought the Stock for £1,400. The Debtors realized £800. The costs of realization were £200 and the Creditors were duly discharged. Prepare final accounts showing the dissolution completed.

(I.B.)

P. X, Y, and Z are partners sharing profits and losses, one-half, one-third, and one-sixth respectively. Their Balance Sheet on the 31st December, 19.., was as follows—

BALANCE SHEET

Liabilities		£	*Assets*	£
Creditors		500	Properties	500
Capital Accounts—			Stock	400
X	£600		Debtors	600
Y	300		Cash	280
Z	200		Current Account—	
		1,100	Z	100
Current Accounts—				
X	£150			
Y	130			
		280		
		£1,880		£1,880

They agree to dissolve partnership. X takes over the Properties for £400. The Debtors realize £550, and the Stock is sold for £420. A total of £20 is allowed as Discount by the Creditors. The costs of realization are £52. Prepare final accounts and close the same. (C.A.A.)

Q. X, Y, and Z enter into partnership. X brings in £800 capital, Y £400, Z £600. Profits and losses are to be shared equally and no interest allowed on partners' capital. In the first year there was a profit of £600. At the end of the second year the partnership was dissolved and the assets realized £1,200. Close the books of the partnership. (There were no drawings by the partners during the partnership.) (C.R.A.)

R. A and B are in partnership, sharing profits and losses two-thirds and one-third. They sell their business to X for £3,000. Goodwill, with Stock, Plant, and Office Furniture at valuation, and Book Debts less 20 per cent Reserve. X takes over the liabilities. Their Balance Sheet is as follows—

BALANCE SHEET

Liabilities	£	*Assets*	£
Capital Accounts—		Plant	1,200
A	2,500	Office Furniture	300
B	2,500	Stock	1,800
Creditors	700	Debtors	1,600
		Cash	800
	£5,700		£5,700

The valuation resulted as follows: Stock, £1,650; Plant, £1,000; Office Furniture, £253. Prepare final accounts as between A and B. (C.A.A.)

S. A and B, in partnership, sharing profits and losses equally, sold their business to J and R. Their Balance Sheet showed—

BALANCE SHEET

Liabilities	£	*Assets*	£
Creditors	3,300	Plant	3,000
		Fixtures, etc.	600
A's Capital	8,000	Stock	8,000
B's Capital	5,000	Debtors	4,000
		Cash in Bank	700
	£16,300		£16,300

The purchasers agreed to pay £2,500 for Goodwill, but to take the Stock at £7,000 and Plant at £2,000. Make up the Capital Accounts of A and B on the terms of sale. (C.R.A.)

T. Wright and Hilder are in partnership sharing profits and losses five-eighths and three-eighths respectively. They each had a Capital of £2,500 in the business, and their drawings during the year ended 31st December, 19.., were Wright £600, Hilder £450. At that date the balances open in their books, in addition to those stated above, were—

	£
Purchases	27,000
Salaries	2,000
Rent	800
Advertising	400
Sales	37,600
Land	500
Wright, Current Account, Cr. Balance	130
Hilder, ,, ,, ,,	330
Returns Outwards	800
Sundry Creditors	782
Carriage Inwards	120
Plant	1,400
Fire Claim paid, Stock of Goods destroyed	1,020
Interest on Investments	50
Stock (opening)	8,080
General Reserve	3,000
Office Furniture	225
Electric Light	64
Goodwill	600
Sundry Debtors	4,160
Income Tax	10
Reserve for Bad Debts	420
Stationery	87
Investments at 5 per cent	2,000
General Expenses	290
Cash at Bank	346

Prepare Trading and Profit and Loss Accounts for the period, and Balance Sheet as at 31st December, 19... The following adjustments are necessary—

Allow for a half-year's interest due on Investments.
Allow Wright a salary of £250 for management.
Depreciate Plant by £200, Office Furniture by £25.
Allow for commission payable of £100 not brought into account.
In a second part to the Profit and Loss Account appropriate £1,000 to General Reserve.
The closing stock was valued at £3,000. (I.B.)

Partnership	Limited Company
(*a*) Management— In the absence of agreement to the contrary, all partners are entitled to take part in the management of the business.	The rights of management and control are vested in a special body of shareholders called "directors."
(*b*) Individuality— The individuality of the members is not entirely lost.	The company is considered in law as a separate and distinct entity, hence the members thereof lose their individuality.
(*c*) Membership— The number of persons who may carry on business together is limited to twenty (in the case of a banking business, to ten).	There is no limit to the members of a limited company except that there must not be less than seven persons in a public company, nor less than two persons in a private company.
(*d*) Contractual Capacity— In the ordinary course, a partner can enter into contracts on behalf of the firm.	Shareholders, as such, do not possess the power to bind the company or transact business on its behalf.
(*e*) Liability— A partner's liability is not confined to his share in the firm, for on insolvency his private estate may be taken to satisfy the partnership creditors.	The liability of each member is restricted to the amount unpaid on the shares he holds.
(*f*) Capital— The capital of a partnership can be increased or decreased by mutual consent.	The capital of a limited company is fixed, and can be altered only in the manner prescribed by law.
(*g*) Accounts— There is no statutory provision regarding accounts, which are audited only at the express wish of the partners themselves.	The law provides that the accounts shall be subject to an independent audit, in addition to stating that certain accounts must be rendered periodically to the shareholders.

and requirements, it might be advantageous if comparison is drawn between the partnership and the joint stock or limited company. This is given on page 101.

Kinds of Companies.

The companies with which the book-keeping student is primarily concerned are those incorporated under the Companies Act, 1929. These are—

(*a*) PUBLIC COMPANIES—

Limited by Shares. These are by far the most numerous in existence; the members thereof are liable only to the extent of any *unpaid* portion of the nominal value of their shares.

Limited by Guarantee. In this case the members guarantee to contribute a specific amount in the event of the company winding-up. These companies are, in the main, confined to public institutions and clubs.

Unlimited. This bears some resemblance to the partnership, the liability of its members being unlimited.

(*b*) PRIVATE COMPANIES. A private company has three characteristics: (1) The right to transfer shares is restricted; (2) Its membership is limited to fifty (exclusive of employees who have become members of the company); (3) Invitation for public subscription of shares or debentures is prohibited.

Memorandum of Association.

All limited companies, in order to obtain registration, must file certain documents with the Registrar of Companies. The most important of these documents are the Memorandum and Articles of Association.

The Memorandum of Association constitutes the charter of the company, stating its objects and defining its powers. Among other particulars it must contain reference to the following—

1. The proposed name of the company, the term "Limited" forming the last word in the name.

2. The registered office of the company.

3. The objects of the company.
4. A declaration that the liability of its members is limited.
5. The nominal amount of capital and particulars of its division into shares.

This document must be signed, in the case of a public company, by not less than seven persons, and, in the case of a private company, by not less than two. Each signatory must agree to take at least one share in the company and the number of shares taken must be stated after the signature. The Memorandum, having received the approval of the Registrar, can be altered only by special resolution, with the sanction of the Court. The name of the company may be changed by special resolution of its members, provided the approval of the Board of Trade is also obtained.

Articles of Association.

The Articles of Association may be regarded as the rules for the internal policy and management of the company. A public company limited by shares need not formulate special articles and may at discretion adopt Table A of the First Schedule of the Companies Act, 1929; a comprehensive and well-arranged set of rules. This privilege is not shared by the other types of limited or private companies, which must register Articles of Association with the Memorandum. The Articles must be printed, stamped, and signed by each subscriber to the Memorandum of Association in the presence of at least one witness. Alteration of the Articles may be made without outside sanction. The change may be effected by means of a special resolution, but must not be inconsistent with the Memorandum of Association, outside the bounds of which it cannot go.

The Table A already referred to is of importance to the book-keeping student, who should endeavour to understand the salient points of this Schedule, which deal with the making of calls; the voting powers of shareholders; forfeiture and reissue of shares; transfer of shares; the powers, duties, remuneration and election of directors; the calling of meetings; appointment and remuneration of auditors, and various other

matters relating to the general conduct of the business of the company.

The Prospectus and Its Contents.

Having obtained registration, the company now proceeds to procure from the public the capital necessary for its working, and to do this a prospectus is issued generally in the form of a newspaper advertisement. The principal contents of a prospectus are set out below—

(*a*) The contents of the Memorandum with the names, descriptions, and addresses of the signatories, and the number of shares subscribed for by them respectively.

(*b*) The number of founders, management, or deferred shares, if any, and the nature and extent of the interest of the holders in the property and profits of the company.

(*c*) The number of shares, if any, fixed by the Articles as providing a director with the necessary qualification and any provision in the Articles as to the remuneration of the directors.

(*d*) The names, descriptions, and addresses of the directors or proposed directors.

(*e*) The minimum amount which, in the opinion of the directors, must be raised by the issue of shares to provide for—

1. The purchase price of any property which has been acquired or which is to be acquired by the company, and which is to be paid for in cash.
2. Any preliminary expenses and commissions payable by the company.
3. Repayment of any loans contracted by the company for the purpose of (1) or (2).
4. Working capital.

(*f*) The amount payable on application and allotment of each share and the intervals following which future instalments may be called for.

(*g*) The names and addresses of the vendors of any property purchased or proposed to be purchased, and the amount payable in cash, shares, or debentures, specifying the amount paid for goodwill.

(*h*) The amount or estimated amount of preliminary expenses.

(*i*) The dates of, and parties to, every material contract.

(*j*) The names and addresses of the auditors, if any, of the company.

(*k*) Full particulars of the nature and extent of the interest of every director connected with the promotion of the company, and concerned with the property to be acquired by it.

(*l*) Where the shares issued are divided into different classes, the rights in respect of voting, capital, and dividends attached to the various classes of shares.

(*m*) Where part of the proceeds is to be applied, directly or indirectly, to the purchase of any business, a report made by the accountants, who shall be named in the prospectus, upon the profits of the business in respect of each of the three financial years immediately preceding the issue of the prospectus.

Where the prospectus for additional capital is issued by a company already in existence, the foregoing will need slight alteration.

A copy of the prospectus to be issued must be (1) signed by all the persons named therein as directors or proposed directors; (2) filed with the Registrar on or before the date of its publication, and (3) state on the face of it that a copy has been so filed. A public company which does not issue a prospectus cannot proceed to allot shares or debentures unless a statement in lieu thereof has been filed with the Registrar. The information contained therein is much the same as that set out above.

Statutory Books.

A limited company is compelled by law to keep certain books for record and statistical purposes, apart from the financial books. These are—

1. *Minute Books*, containing a record of the proceedings and resolutions passed at meetings of the directors and shareholders of the company.

2. *Register of Directors and Managers*, giving particulars of their names, addresses, nationalities, and occupations.

3. *Register of Members* (*with index*) containing (*a*) the name, address, and occupation of every member; (*b*) the number of shares held by each member with the distinguishing numbers of the shares; (*c*) the amount paid up or agreed to be considered as paid on each share; (*d*) the date at which each person was entered in the register and (*e*) the date at which each person ceased to be a member. Where the transactions of the company extend to the Dominions, a separate register is kept for the members residing therein, a duplicate of which is kept at the company's principal place of business.

4. *Register of Charges,* comprising particulars of all mortgages and charges affecting the property of the company, giving in each case a brief description of the property mortgaged or charged.

Formerly, the law contained but very little concerning the financial books, but with the passing of the Companies Act, 1929, these books occasion special comment. Section 122 of this Act states—

> (1) Every company shall cause to be kept proper books of account with respect to—
>
> (*a*) all sums of money received and expended by the company, and all the matters in respect of which the receipt and expenditure takes place;
>
> (*b*) all sales and purchases of goods by the company;
>
> (*c*) the assets and liabilities of the company.
>
> (2) The books of account shall be kept at the registered office of the company or at such other place as the directors think fit, and shall at all times be open to inspection by the directors.

Further provision is made by Sections 123 and 124. The first states that at some date not later than eighteen months after the incorporation of the company and subsequently once at least every calendar year, the directors shall place before the shareholders a Profit and Loss Account and a Balance Sheet, and attached thereto a report by the directors on the affairs of the company; the dividends it is recommended should be distributed and the amounts, if any, it is proposed to carry to reserve. Section 124 stipulates that in the construction of the Balance Sheet some distinction must be made between (*a*) capital represented by actual assets and that absorbed

APPLICATION AND ALLOTMENT BOOK

No. of Application	Date of Application	Name	Address	Description or Occupation	No. of Shares Applied for	Amount Paid on Application			C.B. Fol.
						£	s.	d.	
704	1st Jan 49	M. Brown,	Walpole Street.	Dealer — Raw Cotton.	6	1	2	0	

No. of Shares Allotted	Distinctive No. of Shares		Share Ledger Fol.	Amount due on Application and Allotment			Balance due on Allotment			Cash paid on Allotment			C.B. Fol.	Cash Returned			C.B. Fol.	Share Certificate No.	Remarks
	From	To		£	s.	d.	£	s.	d.	£	s.	d.		£	s.	d.			
6	207	301	—	7	3	0	60	0	0	20	•	•	—	10	0	0	—	1120	Reply for d[illegible] am[illegible]

CALL BOOK

Share Ledger Fol.	Call Letter No.	Name	Address	No. of Shares Held	Amount Due			Date of Payment	Amount Paid			C.B. Fol.	Arrears					Calls paid in Advance			Remarks
													Amount			Days	Interest				
					£	s.	d.		£	s.	d.		£	s.	d.			£	s.	d.	
	30	Brown	London	6	40	0	0	15th M.	20	0	0	—	20	0	0	—	—	40	0	0	n. Satisfied

REGISTER OF TRANSFERS

Date	No. of Transfer	Transferor			Transferee			Shares Transferred						Remarks
		Name	Address	S.L. Fol.	Name	Address	S.L. Fol.	No.	Distinguishing Numbers		Amount Paid up			
									From	To				
1 Mar.	113	Brown	London	—	Brown John	Pool	—	18	302	324	60	0	0	[illegible]

merely in collecting or gathering the capital, i.e. preliminary expenses; expenses incurred in connection with the issue of shares or debentures, and (*b*) fixed and floating assets.

The issue of capital forms a very important part in the company's formation; one might say the all-important part, and it is, therefore, necessary to keep special books to record particulars of those who apply for shares. In addition to the Register of Members the following books should be kept—

1. *Applications and Allotments Book,* which contains particulars of each application for shares; the allotment made; the amounts received and those returned to unsuccessful applicants. (For specimen see page 107.)

2. *Call Book,* which records particulars of calls made and the amounts paid by each shareholder in respect thereof. (For specimen see page 108.)

3. *Register of Transfers* which gives information as to the transfers of shares. A specimen register appears on page 109, and from this it will be seen that, apart from its value as a record of transfers, it facilitates posting to the Register of Members.

Annual Return.

This is a return, required by Section 108 of the Companies Act, 1929, which every company, having a share capital, must compile after the general meeting of members held each year. The return, which must be completed within twenty-eight days of the meeting, is signed by an officer of the company and filed with the Registrar. The contents primarily relate to the capital of the company—these include the number of shares issued since the date of the last return; the total calls received and those unpaid; amounts paid by way of commission in respect of shares or debentures; particulars of any shares forfeited; the total amount of share warrants issued and surrendered since last return; particulars of any mortgages and charges. As can be seen from these items, the return deals, in the main, with the changes which take place in the capital and shares of the company from one year to another. It

also includes a summary of the share capital of the company and its division into shares.

Share Capital.

Particulars of the capital which the company has taken power to raise will be contained in the Memorandum of Association, for it is upon this figure that the company is required to pay an *ad valorem* duty of £1 for every £100 or part thereof. The various terms and their meanings associated with the capital are given below—

1. *Nominal, Registered, or Authorized.* The maximum amount of capital the company, by its Memorandum of Association, is allowed to issue.

2. *Issued or Subscribed.* That portion of the nominal capital subscribed for by the shareholders.

3. *Called-up.* That part of the subscribed capital called-up by the directors on the shares allotted.

4. *Paid-up.* The amount which has been actually paid, or credited as paid, in respect of the capital issued. The amount for which the shareholders still remain liable is termed *uncalled* capital.

5. *Reserve.* That part of the uncalled capital which, by special resolution, is available only for winding-up purposes.

There are other terms linked with the "capital" of the company, but these are used rather to denote the type of asset or assets by which the capital is represented—

Fixed Capital. That which a company retains in the form of assets or property acquired solely for the purpose of producing or earning revenue.

Floating Capital. That represented by assets acquired for the purpose of, or in the course of, business trading, such as cash or goods and similar circulating assets held with a view to early sale or conversion into cash.

Working Capital. The excess of floating or circulating assets over current liabilities.

Classification of Shares.

It was stated earlier on that the capital and a description of the shares into which it was divided must be stated in the

Memorandum of Association. These shares may be further subdivided into various classes, chief of which are Ordinary, Preference, and Deferred. The rights of each class of shareholder may vary and will be determined by the Memorandum and Articles. A summary of the various classes of shares with particulars of the usual privileges attaching to each class appears below.

ORDINARY SHARES are those which, as a general rule, confer no special rights or privileges either in regard to capital or profit. The holders thereof participate in the profits of the company after the preferential rights attaching to other classes of shares have been satisfied. A division of ordinary shares is sometimes made into (1) *Preferred* Ordinary and (2) *Deferred* Ordinary. Holders of the former are entitled to a fixed dividend, and until this has been satisfied, the Deferred Ordinary shareholders do not participate in profit distribution.

PREFERENCE SHARES, which give the holder preferential treatment in regard to dividends, or capital, or both. These carry a fixed dividend payable out of the profit in any one year, any surplus profit going to the holders of ordinary and deferred shares. Preference shares are divided into (*a*) *Cumulative,* the holders of which are entitled, in the event of the profits in any year being insufficient to pay the agreed rate of dividend, to have any arrears payable out of future profits. (*b*) *Non-cumulative,* where, as the term implies, any dividend passed over through insufficient profit cannot be made good out of future profit. (*c*) *Participating,* which entitle the holders to a fixed rate of dividend and a share in the balance of any available profit after the ordinary shareholders have received a fixed rate. (*d*) *Redeemable,* those which carry specified privileges as to payment of dividend and are redeemable at a fixed future date or at the option of the company. These shares, provided they are fully paid, may be redeemed out of profits available for distribution or from the proceeds of a new issue of shares made for the purpose of the redemption.

DEFERRED SHARES are those whose rights to dividend are deferred until the privileges attaching to other shares have been satisfied. For this reason, the value of the shares as

an investment will, to a very large extent, depend upon the success of the business.

FOUNDERS SHARES are, as a rule, few in number and of small nominal value. The holders of these shares, who sometimes have special voting rights, participate in the distribution of profit after all the other shares have received a fixed rate. They are usually given to those responsible for the formation of the company or are issued as fully paid to the vendors of an acquired business.

The difference between *shares* and *stock* is not always appreciated. The chief distinction lies in the fact that the holder of stock may transfer any portion or fraction of his holding. The holder of shares, on the other hand, may only dispose of, or transfer, complete shares. A further distinguishing factor is that whilst shares are numbered and may be partly paid, stock cannot be numbered and is always fully paid. In fact, it might here be noted that stock is never issued as such; it is composed of fully-paid shares which a company, by the terms of its Articles, has converted into blocks of shares called *stock*.

Issue of Shares.

So far, an endeavour has been made to sketch stage by stage the steps which, according to law, have to be taken in connection with the formation or incorporation of a limited company. Having prepared the Memorandum and Articles of Association and obtained registration, the company, as the first step towards the subscription of the capital with which it may commence business, issues a prospectus inviting the public to subscribe for shares. This, of course, applies only to the public company for, as was pointed out in the earlier part of this chapter, a private company is prohibited from seeking public subscription.

The contents of the prospectus are set out on page 104, and perhaps the most important point to which, at this stage, attention must be drawn is that dealing with the minimum amount of capital which, in the opinion of the directors, must be raised to provide the purchase consideration, preliminary

expenses, etc., and the working capital. No allotment of shares may be made unless this amount of capital has been subscribed for, and the sums payable on application have been received by the company. Attached to the prospectus is usually an application form. The intending shareholder completes and forwards this with the application money to the bankers named in the prospectus.

Allotment of Shares.

The bank will prepare and send to the company a daily list of the applications, upon receipt of which the total deposits are debited to the Cash Book and credited to the Application and Allotment Account. The applications are then relisted alphabetically for the benefit of the directors, who proceed to allot the shares. Letters of Allotment are next prepared and sent to each successful applicant, stating the number of shares allotted and the sums thereupon due. The allotment letter, which amounts to an acceptance of the offer made by the applicant, completes the contract, and it must bear a 6d. stamp if the share is £5 or over; a 1d. stamp if the value is under £5. After allotment has been made, the Application and Allotment Account is debited, and the Share Capital Account credited, with the full amount due. The Application and Allotment Account is credited and the Cash Book debited with the allotment moneys when these are received. If all amounts due have been paid, both sides of the first-named account should, therefore, agree. This, however, will not be the case if the number of applications exceeds the number of shares to be allotted. Letters of regret must be prepared and sent to the unsuccessful applicants, together with any deposit money received. To record this, the Application and Allotment Account is debited and the Cash Book credited with the amount returned. Where fewer shares than those applied for have been allotted, there will be a surplus of application money. This surplus is treated as part of the balance due on allotment, and the applicant is informed accordingly.

A company limited by shares, after having made an allotment of shares, must within one month file with the Registrar

for registration (*a*) a return of allotments, stating number and nominal value of shares comprised in the allotment, the names, addresses and descriptions of the allottees, and the amount (if any) paid or due and payable on each share, and (*b*) where shares have been allotted as fully or partly paid otherwise than in cash, a contract in writing constituting the allottee's title to the shares. Moreover, Section 67 of the Companies Act, 1929, provides that, except where the terms of issue state otherwise, share certificates shall be completed for delivery within two months after the allotment has been made.

Calls.

In accordance with the conditions of issue the directors will from time to time request the holder of shares, where these are not fully paid, to pay a portion of the balance outstanding. This is termed a "*call*." The amount due and the period within which payment must be made are stipulated in the notice. Call sheets are prepared in the same manner as those for the application and allotment money, and the total sum due in respect of the call is credited to the Share Capital Account and debited to the Call Account. The Cash Book is debited and the Call Account credited with the call moneys when received. Any balance in the latter account indicates that there are calls outstanding, and this balance will appear in the Balance Sheet as a deduction from the share capital.

Where some calls are paid in advance, usually by shareholders who desire to avoid the possibility of being requested to pay at a time when perhaps they can least afford it, the amount paid in excess will be posted to the credit of a separate account headed "Calls in Advance," the Cash Book being debited. When the call becomes due, the balance of the Calls in Advance Account is transferred to the credit of the appropriate Call Account.

Underwriting.

The student may have observed the possibility that the public might not be attracted by the terms connected with the issue of capital, with the result that the shares taken in

response to the company's invitation are considerably below the number offered. To provide against this contingency, an agreement is entered into by the company with a firm of underwriters who, in consideration of a stipulated commission, undertake that they themselves will apply, or find responsible persons to apply, for the balance or a specific proportion of the balance not taken up by the persons to whom subscription is originally offered. It will thus be seen that where the underwriters are compelled to accept shares, the company does not obtain their full value in view of the commission payable to the underwriters, and the shares are, therefore, virtually issued at a discount. Commission paid to brokers who agree either to procure underwriters or subscribers for shares, which must not be confused with underwriting commission, is permitted under Section 43 of the Companies Act, 1929. The conditions attaching to the payment of this commission are—

1. The payment must be authorized by the Articles of Association.

2. The amount must not exceed the rate stipulated in the Articles or, if no rate is given, must not exceed 10 per cent of the price at which the shares are offered.

3. Full information as to the commission and the number of shares involved must be disclosed in the prospectus or, if no prospectus is issued, in the statement in lieu thereof.

The entries necessary when the underwriter is required to take up shares are similar to those that are made when applications are received from the public, except that a separate account is opened for the underwriter.

EXAMPLE 1. The X.Y.Z. Stores, Ltd., made a public issue of 100,000 £1 shares at par payable as follows: 2s. 6d. on application, 2s. 6d. on allotment, and the balance when required. Underwriting agreements were entered into, and A underwrites 10,000 shares, B 15,000 shares, C 15,000 shares, and D 20,000 shares, for a commission of 2½ per cent. As a result of the public subscription, applications were received for 70,000 shares, leaving the underwriters with a liability of 30,000 shares. Show the Journal entries, the Cash Book and

Ledger Accounts after the above transactions have been recorded.

The underwriters' individual liability will be determined as follows—

	Shares Under-written	Proportion	Net Liability	Amount Due on Application and Allotment
				£
A	10,000	$\frac{10}{60}$ths of 30,000	5,000	1,250
B	15,000	$\frac{15}{60}$ths of 30,000	7,500	1,875
C	15,000	$\frac{15}{60}$ths of 30,000	7,500	1,875
D	20,000	$\frac{20}{60}$ths of 30,000	10,000	2,500
	60,000		30,000	£7,500

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				£	£
	Application and Allotment Account . . . . *Dr.*			17,500	
	To Share Capital Account .				17,500
	Being 5s. per share (2s. 6d. on Application and 2s. 6d. on Allotment) on 70,000 shares allotted to sundry applicants as per resolution dated 19				
	Application and Allotment Account . . . . *Dr.*			7,500	
	To Share Capital Account .				7,500
	Being 5s. per share (as above) on 30,000 shares allotted to sundry underwriters as per resolution dated ....19........				
	Sundry Underwriters' Account *Dr.*			7,500	
	To Application and Allotment Account				7,500
	Being transfer of amounts paid on shares allotted to underwriters.				

Dr. CASH BOOK *Cr.*

		£			£
	To Application and Allotment (Sundry Underwriters)—			By Underwriting Commission—	
	A, 5,000 shares .	1,250		A . . .	250
	B, 7,500 ,,	1,875		B . . .	375
	C, 7,500 ,, .	1,875		C . . .	375
	D, 10,000 ,,	2,500		D . . .	500
	,, Application and Allotment Account (Sundry Applicants) . . .	17,500			

Dr. APPLICATION AND ALLOTMENT ACCOUNT *Cr.*

		£			£
	To Share Capital A/c	17,500		By Cash . .	17,500
	,, ,, ,, ,,	7,500		,, Sundry Underwriters . .	7,500
		£25,000			£25,000

Dr. SHARE CAPITAL ACCOUNT *Cr.*

					£
				By Application and Allotment A/c .	17,500
				,, Application and Allotment A/c .	7,500

Dr. SUNDRY UNDERWRITERS' ACCOUNT *Cr.*

		£			£
	To Application and Allotment A/c .	7,500		By Cash . .	7,500

Dr. UNDERWRITING COMMISSION ACCOUNT *Cr.*

		£			£
	To Cash .	1,500		By Preliminary Expenses . .	1,500

It is sometimes agreed that the underwriters shall, before the issue of shares, make a deposit of the application money or a portion thereof on the number of shares underwritten. The Cash Book is debited and the Sundry Underwriters' Account credited with the amount they agree to pay. If, as

is generally the case, the underwriters are called upon to take considerably fewer shares than those underwritten, any balance in excess of the amount due on allotment will have to be returned to them, the Cash Book being credited and the Sundry Underwriters' Account debited with the sum returned. The Share Capital Account is not affected.

EXAMPLE 2. On the 1st January, a company was formed with a nominal capital of £50,000 divided into 40,000 Ordinary shares of 10s. each and 30,000 Preference shares of £1 each. The offer to the public was made on the following terms—

Ordinary shares—

2s. 6d. per share on application.
2s. 6d. ,, ,, allotment.
5s. ,, ,, 1st March.

Preference shares—

5s. per share on application.
5s. ,, ,, allotment.
10s. ,, ,, 1st March.

Of the shares offered, the following were applied for—

35,000 Ordinary shares.
25,000 Preference shares.

All cash due on application and allotment was received, but, in respect of the calls, at the 31st March the following amounts had been received—

Ordinary shares—

On 33,500 shares the full sum due.
,, 1,500 ,, 5s. per share.

Preference shares—

On 22,000 shares the full sum due.
,, 3,000 ,, 10s. per share.

Show by means of Journal entries and Ledger accounts how these transactions would appear in the company's books as at 31st March.

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				£	£
Jan. 1	Ordinary Share Application and Allotment Account . *Dr.*			8,750	
	To Ordinary Share Capital A/c .				8,750
	Being 5s. per share payable on 35,000 shares allotted.				
	Preference Share Application and Allotment Account . . *Dr.*			12,500	
	To Preference Share Capital A/c				12,500
	Being 10s. per share payable on 25,000 shares allotted.				
Mar. 1	Ordinary Share Call Account *Dr.*			8,750	
	To Ordinary Share Capital A/c .				8,750
	Being a call of 5s. per share on 35,000 shares.				
	Preference Share Call Account *Dr.*			12,500	
	To Preference Share Capital A/c				12,500
	Being a call of 10s. per share on 25,000 shares.				

Dr. CASH BOOK

19..				£
Jan. 1	To Ordinary Share Application and Allotment Account			8,750
	,, Preference Share Application and Allotment Account			12,500
Mar. 1	,, Ordinary Share Call Account . . .			8,375
	,, Preference Share Call Account . .			11,000

Dr. APPLICATION AND ALLOTMENT ACCOUNTS *Cr.*

			Ord. Shares	Pref. Shares				Ord. Shares	Pref. Shares
19..			£	£	19..			£	£
Jan. 1	To Share Capital Accounts .		£8,750	12,500	Jan. 1	By Cash . .		£8,750	12,500

Dr. CALL ACCOUNTS *Cr.*

		Ord. Shares	Pref. Shares			Ord. Shares	Pref. Shares
		£	£			£	£
19.. Mar. 1	To Share Capital Accounts .	8,750	12,500	19.. Mar. 1	By Cash . .	8,375	11,000
				31	,, Balance c/d .	375	1,500
		£8,750	12,500			£8,750	12,500
Apr. 1	To Balance b/d .	375	1,500				

Dr. SHARE CAPITAL ACCOUNTS *Cr.*

		Ord. Shares	Pref. Shares			Ord. Shares	Pref. Shares
		£	£			£	£
				19.. Jan. 1	By Application & Allotment Accounts .	8,750	12,500
				Mar. 1	,, Call Accounts	8,750	12,500

Shares at a Premium.

A series of very profitable years may have a considerable effect on the market value of a company's shares, and it is probable that where a company desires further capital it can and does obtain a higher price than the nominal value of each share. The excess is termed a "premium," and when shares are offered under this condition it is necessary to open a Premium on Shares Account in addition to the usual accounts for recording the issue of capital. To the credit of this account is posted the premium, which should stand in the final accounts as a permanent reserve or be applied to the reduction of such fictitious assets as preliminary expenses or underwriting commission.

EXAMPLE 3. The Washington Co., Ltd., offers 50,000 Ordinary shares of a nominal value of £1 for subscription at the price of 25s. per share, payable 10s. per share on application (including the premium), 5s. per share on allotment, and the balance as and when required. Give the Journal entries necessary to record these transactions and the Application and Allotment Account.

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			£	£
	Application and Allotment Account . . . . . *Dr.*		37,500	
	To Share Capital Account .			25,000
	,, Premium on Shares Account			12,500
	Being total amount payable on application and allotment (including premium of 5s. per share) on 50,000 shares.			
	Cash . . . . . . *Dr.*		25,000	
	To Application and Allotment Account			25,000
	Being amounts received on application for 50,000 shares at 10s. per share.			
	Cash . . . . . . *Dr.*		12,500	
	To Application and Allotment Account			12,500
	Being amounts received on allotment of 50,000 shares at 5s. per share.			

NOTE. Cash entries have been journalized because no Cash Book is given.

Dr. APPLICATION AND ALLOTMENT ACCOUNT *Cr.*

			£				£
	To Share Capital Account . .		25,000		By Cash		25,000
	,, Premium on Shares Account . .		12,500		,, ,, ...		12,500
			£37,500				£37,500

Shares at a Discount.

It is only with the passing of recent legislation that a company is permitted to issue shares at a discount. The chief objection to this in the past came from the creditors of the company, who rightly argued that such a discount amounted to a reduction of capital. Section 47 of the Companies Act, 1929, which gives the necessary authority for a company to issue at a discount shares of a class already issued, is so framed

as to safeguard the interests of those to whom such an issue is likely to prove detrimental. The chief points are—

(1) The issue of shares at a discount must be authorized by the shareholders and sanctioned by the Court;

(2) The resolution of the members must specify the rate of discount, and

(3) At least one year must have elapsed since the commencement of business.

The entries required to be made in the books will be very much the same as those recorded when shares are issued at a premium, a special account being opened for the discount (instead of for the premium). Any discount on shares issued must be included in the Balance Sheet until it is finally written off (Companies Act, 1929). In the absence of the Cash Book, the cash entries in the example which follows have been journalized.

EXAMPLE 4. The Washington Co., Ltd., decided to issue the balance of its Ordinary Share Capital, 50,000 £1 shares, at a discount of 5s. per share, thus completing the issue of its authorized capital of £150,000. The shares were payable as follows: 2s. 6d. on application, 5s. on allotment, and a call of 7s. 6d. Give the Journal entries to record the above transactions and show how the capital would appear in the Balance Sheet. This solution appears on page 124.

Transfer and Transmission.

The transfer of shares is effected by means of a written instrument. This instrument, with the share certificate, is lodged for registration with the company which, in due course, issues a new certificate to the transferee. Particulars of the transfer will appear in the Register of Transfers, a specimen of which appears on page 109. When only part of the holding is transferred, a Balance Ticket will be handed to the transferor pending the preparation of the new share certificates.

Transmission is the devolution of the title to shares other than by transfer. It is obvious, on the death of a shareholder, that the ordinary form of transfer cannot be executed. Instead, the personal representative of the deceased

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			£	£
	Cash . . . . . . *Dr.* To Application and Allotment Account . . . . . . Being 2s. 6d. per share on 50,000 shares received on application.		6,250	6,250
	Application and Allotment Account . . . . *Dr.* To Share Capital Account . Being total amounts due on allotment (2s. 6d. on application and 5s. on allotment) of 50,000 £1 shares issued at 15s. in accordance with resolution dated..... .... 19....		18,750	18,750
	Cash . . . . . . *Dr.* To Application and Allotment Account . . . . . Being 5s. per share on 50,000 shares received on allotment.		12,500	12,500
	Call Account . . . . *Dr.* To Share Capital Account . Being 7s. 6d. per share due on 50,000 shares.		18,750	18,750
	Cash . . . . . *Dr.* To Call Account . . . . Being 7s. 6d. per share for the first and final call received on 50,000 shares.		18,750	18,750
	Discount on Shares Account *Dr.* To Share Capital Account . Being the discount of 5s. per share on 50,000 £1 shares in accordance with resolution dated ....19....		12,500	12,500

BALANCE SHEET

Liabilities	£	*Assets*	£
Issued Capital— 150,000 Ordinary shares of £1 each, fully paid .	150,000	Discount on Shares Account . . .	12,500

shareholder forwards a copy of the probate or letters of administration, and entry is thereupon made in the Register of Members. When the shares are sold or transferred, particulars are sent to the company which then enters the name and address of the new holder in the Register.

Forfeited Shares.

An issue of shares to the public is generally paid for by a number of instalments called "calls," and failure on the part of the shareholder to comply with a call notice within a specified time leads to the shares concerned being declared forfeited by the directors. The Articles of the company set forth the procedure and rules of forfeiture, which must be rigidly adhered to. The effect of forfeiture is that the share capital is reduced, and the balance outstanding in the Call Account is transferred to a Forfeited Shares Account. A summary of the entries necessary to adjust the Capital and Call Accounts is given below—

1. Debit Share Capital Account and credit Forfeited Shares Account with the amount called up on the shares forfeited.

2. Debit Forfeited Shares Account and credit the appropriate Call Account with the instalment unpaid by the shareholder at the time of forfeiture.

EXAMPLE 5. The nominal and issued capital of a limited company consists of 20,000 shares of £1 each. The terms of issue were 10s. on application and allotment, the balance being payable in two calls of 5s. each. On the 5th February, after due notice, the directors passed a resolution forfeiting the 2,000 shares held by Mr. P. Norman, in respect of which the second call of 5s. was due but unpaid. Show the Journal entries and the Ledger accounts affected. (See overleaf.)

The balance to the credit of the Forfeited Shares Account will appear in the Balance Sheet as a liability until such time as the shares are reissued.

Reissue of Forfeited Shares.

After forfeiture the directors are empowered to reallot the shares to a new shareholder at the best price they can obtain,

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19.. Feb. 5	Share Capital Account . *Dr.* To Forfeited Shares Account . Being forfeiture of 2,000 shares allotted to Mr. P. Norman for non-payment of the second call of 5s. as per resolution dated................19...		£ 2,000	£ 2,000
	Forfeited Shares Account . *Dr.* To Second Call Account . . Being transfer of the call unpaid on forfeiture of the above shares.		500	 500

Dr. SHARE CAPITAL ACCOUNT *Cr.*

19.. Feb. 5	To Forfeited Shares Account . .		£ 2,000	19.. Feb. 5	By Balance . . .		£ 20,000

Dr. SECOND CALL ACCOUNT *Cr.*

19.. Feb. 5	To Balance c/d . .		£ 500	19.. Feb. 5	By Forfeited Shares Account . .		£ 500

Dr. FORFEITED SHARES ACCOUNT *Cr.*

19.. Feb. 5	To Second Call A/c		£ 500	19.. Feb. 5	By Share Capital A/c .		£ 2,000

provided the nominal value is received from both the old and new shareholders. In effect, this means that the shares may not be disposed of for less than the amount outstanding at the time of forfeiture. In many cases, the shares are sold at a premium, the company thereby receiving more than the nominal value of the shares. The following are the entries which will be passed through the books when the shares are reissued, say, at a premium—

1. Debit Forfeited Shares Account and credit Share Capital Account with the amount called up on the shares reissued.

2. Debit Cash and credit Forfeited Shares Account with the sum received from the new shareholder.

3. Debit Forfeited Shares Account and credit Premium on Shares Account with the amount of the premium.

The result of these entries should be obvious. The Share Capital Account is first reduced and then restored to its original figure; the outstanding balance in the Call Account is written off and, as in the example which follows, there remains a balance in the Forfeited Shares Account representing the excess which the company has received over the par or nominal value of the shares reissued. This balance, which is usually transferred to a Premium on Shares Account, will appear amongst the liabilities in the Balance Sheet and may be absorbed in a general reserve or used to reduce the Preliminary Expenses Account.

EXAMPLE 6. For the purpose of illustration, assume that the shares in the previous example were reissued on the 1st May to Mr. A. White for £1,000. To record this transaction, the following Journal entries would be made—

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			£	£
19.. May 1	Forfeited Shares Account . *Dr.*		2,000	
	To Share Capital Account .			2,000
	Being reissue of 2,000 shares previously forfeited to Mr. A. White in accordance with resolution dated ....19........			
	Cash . . . . . . *Dr.*		1,000	
	To Forfeited Shares Account .			1,000
	Being cash paid by Mr. A. White in respect of the above shares at 10s. per share.			
	Forfeited Shares Account . *Dr.*		500	
	To Premium on Shares Account			500
	Being transfer of premium of 5s. per share payable on reissue of the above shares.			

Dr. SHARE CAPITAL ACCOUNT *Cr.*

19..		£	19..			£
Feb. 5	To Forfeited Shares Account	2,000	Feb. 5	By Balance		20,000
			May 1	,, Forfeited Shares Account		2,000

Dr. FORFEITED SHARES ACCOUNT *Cr.*

19..		£	19..		£
Feb. 5	To Second Call Account	500	Feb. 5	By Share Capital A/c	2,000
May 1	,, Share Capital A/c	2,000	May 1	,, Cash	1,000
	,, Premium on Shares Account	500			
		£3,000			£3,000

Dr. PREMIUM ON SHARES ACCOUNT *Cr.*

			19..		£
			May 1	By Forfeited Shares Account	500

Debentures.

Where the Memorandum and Articles of Association give the necessary power, a company may borrow capital in the form of debentures. In the absence of specific permission, a special resolution is required. *Debentures* are separate bonds or certificates of indebtedness either repayable at a future date or irredeemable. *Debenture Stock* is a loan consolidated into one sum for the purpose of convenience. The principle of transfer is similar to that involved by the transfer of the ownership of shares; a debenture may be transferred only in its entirety; debenture stock may be transferred in whole or in part. Debentures may be divided into—

1. Naked debentures, i.e. unsecured debentures which give no charge on the assets.

2. Mortgage debentures, those in respect of which certain assets are charged or mortgaged, viz. (*a*) floating or general charge on all assets, or (*b*) a fixed charge upon certain specific assets only.

A further classification deals primarily with the right to transfer. *Bearer* debentures are those payable to bearer, with

or without power to be registered as a holder. *Registered* debentures are those payable to the registered holder, a transfer of which must be effected through the company. The interest on the latter class is paid by an interest warrant sent periodically to the holder on the due date. This is not possible in the case of bearer debentures, where interest is paid by means of coupons attached to the debenture bond.

The rights of the debenture-holder and the shareholder are in no way the same. In the first place, a shareholder is a *member* of the company, whereas the debenture-holder is a loan *creditor*. Secondly, whilst the holder of shares is entitled to a dividend payable only out of profit, the return to the debenture-holder is in the nature of interest, fixed and chargeable as a working expense and in no way determined or varied by the amount of profit made. Lastly, the shareholder has the right to attend meetings of the company and express his views on its affairs—the holder of debentures has no such right.

Issue of Debentures.

Before an issue of debentures can be made, particulars must be filed with the Registrar. In addition, the company must enter these particulars in its Register of Charges, which is one of the statutory books required to be kept. The procedure then followed is similar to that outlined for the issue of shares. Where the debentures are not paid for in full on application, separate books will be kept for the application, allotment, and call moneys. Special registers will also be used to record the names and addresses, etc., of those who apply for the debentures and any transfers which subsequently take place.

Where the debentures are issued at a premium or discount, the entries to be made in the books will be the same as those described on pages 121–122. If issued at a premium, the difference between the nominal value of the debentures and the amount received by the company must appear in the balance sheet as a separate liability until it is transferred to reserve. Debentures issued at a discount require the creation of a

special Debenture Discount Account. The balance of this represents a fictitious asset which should be written off out of profit during the term of the debentures. The Discount Account thus has the appearance of an asset account which is subject to depreciation under the fixed instalment method. Debentures are sometimes issued as a collateral security for an overdraft at the bank. The financial books will not be affected by this issue—no cash is actually received. The bank allows the company use of certain credit in return for a charge on its assets and property. The overdraft will appear on the liabilities side of the Balance Sheet and a note to the effect that the overdraft is secured by the issue of First Mortgage Debentures is appended, which means that the bankers have a prior right to the repayment of this loan in the event of the winding-up or liquidation of the company.

Redemption of Debentures.

It has already been stated that debentures may be *perpetual* or *redeemable*. The terms of such redemption, where debentures are redeemable, will vary with the conditions of issue, but the three most common methods are: (*a*) out of profit; (*b*) out of capital, and (*c*) by means of a sinking fund. In addition to the foregoing, a company is empowered by the Companies Act, 1929, to reissue redeemable debentures either by reissuing the same debentures or by issuing others in their place. This power is subject to any contrary provision in the Articles or any resolution passed by the members of the company.

(*a*) The first method involves an appropriation of profit which, in the ordinary course, would be distributed to the shareholders in the form of dividends or added to the company's general reserve.

EXAMPLE 7. Instead of declaring a dividend, a company with a balance of undistributed profit amounting to £8,000 decides to repay its £7,000 debentures now redeemable, at a premium of 5 per cent. Give the Journal entries necessary.

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		£	£
Profit and Loss Account . *Dr.* To Appropriation Account . Being transfer of profit in accordance with resolution dated............... 19........		7,350	7,350
Appropriation Account . *Dr.* To Debenture Redemption (Premium) Account . . . Being premium on debentures now redeemed.		350	350
Debentures Account . . *Dr.* Debenture Redemption (Premium) Account . . . . . . To Debenture-holders' Account . Being transfer of balances.		7,000 350	7,350
Debenture-holders' Account . *Dr.* To Cash . . . . . . Being repayment of debentures.		7,350	7,350
Appropriation Account . *Dr.* To Capital Reserve Account . Being transfer of profit to Capital Reserve equal to the debentures repaid.		7,000	7,000

What is the effect of these entries? Before repayment there were two liabilities; one to persons outside the company in the form of debentures, and the other, a balance of profit undivided which is really a liability towards its shareholders. Profit is absorbed to pay the debenture-holders; cash is reduced when payment is actually made, and the surplus of assets which then exceed liabilities (that surplus by which the debentures were represented) is termed a "capital reserve." As was pointed out in Chapter III, this type of reserve exists only while there is a surplus of assets. The disappearance of this surplus means the elimination of the reserve—provided the assets are correctly valued, for it must not be overlooked that with the desire to retain the required surplus, the assets may be overvalued.

(*b*) Repayment out of capital is generally made by means of annual drawings. This method, therefore, bears some resemblance to the fixed instalment system of providing for depreciation, where the cost of the asset (in this case it is a liability) is written off over its life (or term).

EXAMPLE 8. A limited company issued £5,000 debentures at a discount of 5 per cent, repayable by means of annual drawings of £500. Assuming that the discount is to be written off over the term of the debentures, show how the entries would be made in the Cash Book and Ledger Accounts for the first year.

Dr. CASH BOOK *Cr.*

							£
					By Redeemed Debentures Account		500

Dr. REDEEMED DEBENTURES ACCOUNT *Cr.*

			£				£
	To Cash		500		By Debentures Account		500

Dr. DEBENTURES ACCOUNT *Cr.*

			£				£
	To Redeemed Debentures Account		500		By Cash		4,750
	,, Balance c/d		4,500		,, Discount		250
			£5,000				£5,000
					By Balance b/d		4,500

Dr. DEBENTURE DISCOUNT ACCOUNT *Cr.*

			£				£
	To Debentures Account		250		By Profit and Loss		25
					,, Balance c/d		225
			£250				£250
	To Balance b/d		225				

(*c*) The last method, that by which the debentures are redeemed out of the proceeds of sinking fund investments, is probably the most widely used of the three methods explained. A sum is calculated which, reserved annually, will

with interest eventually be sufficient to redeem the debentures. The amount so reserved is placed to a sinking fund, suitable investments are purchased and from the proceeds of the sale of these investments the holders of debentures are paid at maturity. A summary of the entries necessary when this method is adopted and a very clear exposition of its working, are given in the chapter on Sinking Funds. (See page 48.)

Preliminary Expenses.

So much has been said of the issue of capital that perhaps it would be advisable to close this chapter with an account of the manner in which all those expenses incidental to company formation and the issue of capital are dealt with. Preliminary Expenses, as the term implies, are those costs and charges incurred up to the time at which the certificate entitling the company to commence business is obtained. They will include the legal costs in preparing the Memorandum and Articles of Association, the printing of these documents, the printing of the prospectus, the Allotment and Call letters, share certificates, the cost of circulating and advertising the prospectus, stamp duties, and other miscellaneous charges.

The expenditure under this heading is clearly a loss, and, whilst it appears in the Balance Sheet as an asset, it is obviously fictitious. That it should be written off out of future profits of the company is correct, but to charge the whole of the expense to the first trading year would be an unfair burden. For this reason it is accordingly the practice to spread the cost over a number of years by debiting the Profit and Loss Account with a specific proportion annually. Until such time as the amount is finally eliminated, any portion not written off appears in the Balance Sheet amongst the assets.

EXERCISE V

A. Sketch the procedure to be followed on the formation of a joint-stock company.

B. Name *three* matters for the verification of which reference would be necessary to the Articles of Association of a company whose first annual accounts you are preparing. (L.C.C.)

C. What are the essential factors which must be shown in a prospectus of a company wishing to issue its shares to the public? (C.R.A.)

D. What books of account must be kept by a limited company? What additional books are usually kept? (C.R.A.)

E. Sketch a ruling suitable for the following books—

(*a*) Register of Members and Shares.
(*b*) Application and Allotment Book.
(*c*) Transfer Register.

F. How can a limited company create "Reserve Capital," and what is the nature of such capital? (C.R.A.)

G. Name three different classes of shares commonly issued by limited companies, and briefly sketch their characteristics, and the rights of the holders *inter se*. (R.S.A.)

H. Submit the entries necessary to record a fresh issue of Ordinary shares at a premium by an old established company. Select your own details. (L.C.C.)

I. Explain how premiums received on an issue of shares may be dealt with in the books of a limited liability company, and which method you advise. State your reasons. (C.A.A.)

J. In the preliminary expenses of a company, what expenditure is generally comprised? (C.R.A.)

K. A limited company has a nominal capital of £250,000, in 25,000 shares of £10 each. Of these, 4,000 shares were issued to the vendors as fully paid, 8,000 shares were subscribed for by the public, and during the first year £5 per share was called up. 2,000 shares were issued, as fully paid, to persons other than the vendors, in payment for property purchased. On the 8,000 shares subscribed for by the public there had been paid at the end of the first year—

On 6,000 shares, the full amount called.
,, 1,250 shares, £4 per share.
,, 500 shares, £3 per share.
,, 250 shares, £2 per share.

The directors forfeited the 750 shares on which less than £4 had been paid.

You are required to submit Journal and Cash Book entries recording the capital transactions of the company, and to set out the capital as it should appear in the company's Balance Sheet at the end of the first year. (L.C.C.)

L. The Mantyluaket Tea and Rubber Co., Ltd., was formed with a nominal capital of £100,000, divided into 50,000 Ordinary shares and 50,000 Preference shares of £1 each. Twenty thousand

of the former were allotted as fully paid to the vendors, while the balance of these shares and all the Preference shares were offered for public subscription on 1st July, being payable as follows—

2s. 6d. per share on application.
3s. 6d. ,, ,, on allotment.
4s. ,, ,, one month after allotment.
10s. ,, ,, three months after allotment.

All the Ordinary and 40,000 of the Preference shares were applied for and paid up in due course. Show the position by means of the necessary Ledger Accounts. (C.R.A.)

M. Blanks, Ltd., allotted 100,000 £1 Ordinary shares at a premium of 2s. 6d. per share, and 200 6 per cent Debentures of £100 each at 95. Give the entries necessary to record the above issues in the books of the company. (R.S.A.)

N. The Bainbridge Manufacturing Co., Ltd., has applications for 25,000 £1 Ordinary shares and 20,000 £1,5 per cent Preference shares. Payment was to be made by 2s. 6d. per share on application, 5s. per share on allotment, 7s. 6d. on first call, and the balance when required. Allotment took place on the 1st July, and the first call was made on the 1st September. All money was received on due dates, except the first call on 120 Ordinary shares; these shares were forfeited on the 1st October, and reissued on that date as 15s. paid for 12s. 6d. per share.

Show the necessary entries in the books to record these transactions and prepare a Balance Sheet. (I.B.)

O. The Surrey Trading Co., Ltd., offered on the 1st February, 50,000 Ordinary shares of £1 each for public subscription at a premium of 2s. 6d. per share, on the following terms—

Application 5s., including premium.
Allotment 5s.
Final Call 12s. 6d. (1st June).

The amount received on application was £15,000. The company went to allotment on the 10th February, the directors returning the application money and premium on 5,000 shares, and carrying forward the application money and premium on 5,000 shares to Allotment Account. All allotment money was received by the 28th February, and all money due on final call by the 1st July except that for 50 shares, which shares were forfeited on the 1st August and reissued on that day at 17s. 6d. for cash.

Show the Journal entries necessary to record the above transactions, post to Ledger Accounts and extract a Trial Balance. (I.B.)

P. The Yarmouth Property Co., Ltd., was registered on the 1st January, 19.., with a nominal capital of £100,000 divided into 40,000 6 per cent Preference shares of £1 each, and 60,000 Ordinary shares of £1 each. An issue was made to the public of 30,000 Ordinary shares at par, and 30,000 6 per cent Preference shares at 105 payable as follows—

On Application 5s.
On Allotment 7s. 6d.
First Call (on 1st March) 5s.
Final Call (on 1st May) 2s. 6d.

The premium on the Preference shares was payable with the allotment money. The company went to allotment on the 1st February, and the whole issue was fully subscribed. All calls were paid when due except those relating to 200 Ordinary shares on which the first call was not paid. The shares were forfeited on the 1st April, and immediately reissued as fully paid for 15s. each.

Record the above transactions in the books of the company, and show the opening Balance Sheet. Preliminary expenses amounting to £1,500 were paid on the 10th February.

(C.A.A.)

Q. A company has issued £400,000 in shares, one-half in Ordinary and one-half in 6 per cent Redeemable Preference shares, redeemable at the option of the company. In December, 19.., the company decide to redeem £100,000 out of £150,000 available profits.

Show the accounts affected and the entries to be made therein, also the balances as they will appear in the Balance Sheet.

(C.A.A.)

R. The Morley Trading Co. has an issued capital of £500,000 in 500,000 Ordinary shares of £1 each. The directors of the company forfeit 200 of these shares on which 17s. 6d. has been called up, but upon which only 15s. has been paid. The shares were subsequently reissued as fully paid at 10s. per share. You are required to show the entries in the company's books consequent upon the forfeiture and reissue.

S. A company has 250 debentures of £100 each which have been issued at a *discount of* 5 *per cent.* The discount on debentures has already been written off. On the 1st May it was arranged to convert the debentures into the appropriate number of Ordinary shares of £1 each fully paid. Show the necessary Journal entries, and the Ledger Accounts affected thereby. (I.B.)

T. A company issues £100,000 5 per cent Debenture Stock at 96 per cent, and pays 3 per cent Underwriting Commission. The whole of the Debenture Stock is taken up. Show the Journal

entries necessary to record these transactions, and how the issue would appear in the Balance Sheet.

U. Dickson & Co., Ltd., made a public issue of 100,000 Ordinary shares of £1 each, payable as follows—

2s. 6d. on application.
2s. 6d. „ allotment (7th June).
5s. „ 1st December (First Call).
5s. „ 1st March (Second Call).
5s. „ 1st June (Final Call).

John Jones applied for and was allotted 600 of these shares, and duly paid the amount due on allotment and the first call. He failed to pay the second call, and in May the directors forfeited the shares, reissuing them to William White as 15s. paid a few days later, at the price of 11s. per share. White duly paid the final call. Show the entries recording the forfeiture and reissue as they would appear in the company's books of account, and the entries under the heading of Jones and White in the Register of Members and Share Ledger. (L.C.C.)

V. The Hunslet Manufacturing Co., Ltd., decided to issue the balance of its £1 Ordinary shares (10,000) at a discount of 2s. per share, thus completing the issue of its authorized capital of £50,000. The shares were payable in the following manner: 6s. on application, 4s. on allotment, and two calls of 4s. each. Give the Journal entries necessary to record these transactions, and show how the capital and discount would appear in the Balance Sheet.

W. The capital of the Slate Quarry Coal Co., Ltd., is made up of 200,000 £1 shares, all fully paid, with the exception of 220 shares on which the final call of 5s. had not been met. The directors forfeit these shares, and reissue them as fully paid for 10s. each. Show the position by means of Ledger Accounts. (C.R.A.)

X. The following transactions occurred during the conduct of the year's business of a limited company. State how you would deal with them in the accounts of the company—

(*a*) Underwriting Commission, £2,850, and Brokerage, £295, on a new issue of shares.

(*b*) Obsolete Machinery, standing in the books at £2,140, was sold for £1,000, and replaced by new plant costing £6,875.

(*c*) Five hundred 6 per cent Debentures of £100 were issued at 102, the expenses of the issue being £1,480. (R.S.A.)

Y. A company has £20,000 Debentures which can be repaid at any time at 105. Having had a successful year showing a net profit of £15,000, the company decided to pay off one-half of the Debentures. The Balance Sheet in a condensed form is as follows.

BALANCE SHEET

Liabilities		£	*Assets*		£
Capital . . .		29,000	Properties . . .		42,000
Debentures . . .		20,000	Stock		5,000
Creditors . . .		890	Debtors . . .		3,000
Profit and Loss A/c—			Cash—		
Fwd. .	£2,110		Deposit A/c	£12,000	
Profit .	15,000		Current A/c	5,000	
		17,110			17,000
		£67,000			£67,000

Show the entries necessary to be made in the books to record the transactions and the Balance Sheet after the repayment has been made. (C.A.A.)

Z. What is a Debenture? Give the entries necessary to record in the books and Balance Sheet of Blanks, Ltd., the issue of 100 6 per cent Debentures of £100 each, issued at 98. (R.S.A.)

CHAPTER VI

JOINT STOCK COMPANY ACCOUNTS (*continued*)

AN endeavour has been made in the previous chapter to explain in detail the various matters, both from a legal and an accountancy point of view, which arise on the formation of a limited company. The major part of this chapter, therefore, deals with the affairs of the company after its incorporation and in the course of its business. But, before these affairs are discussed, it would seem advisable to give the entries which have to be made where a company is formed to take over an existing business.

Purchase of a Business.

In every branch of industry it will be noticed that the majority of the larger concerns are public companies. Large-scale production and enterprise have brought into prominence the need for a large circulating capital, and it is to this factor mainly that the sale of a partnership or an individual business can be attributed. The method of closing the books where a partnership is taken over by a company is explained in Chapter III, and it is now intended to show those entries which must be made in the new company's books. It will first be necessary to calculate the assets and/or liabilities which are to be taken over by the new concern. Any difference between the net value of the old business and the purchase consideration, i.e. the cash paid, or value of shares allotted, to the vendors, represents the goodwill acquired by the company. It is usual for the company to make a public issue of shares, and the procedure outlined in the previous chapter will then be followed.

A special account will be opened for the vendors, which is debited with the liabilities and credited with the assets taken over. The Cash Book will be credited and the Vendors' Account debited with the purchase price when this is paid in cash.

If shares are allotted to the vendors in addition to the payment of cash, the Share Capital Account is credited and the Vendors' Account debited with the nominal value of the shares allotted. Separate accounts will also be opened for the assets and liabilities, and it is here that the student will observe the difference in the entries made between the company formed to commence business and that formed to take over an existing business, for, in the case of the former, it has no asset accounts until property and material are purchased, and no liability accounts until it commences trading and incurs obligations.

An alternative method is to pass all entries first through a Business Purchase Account in the following manner—

1. Debit Business Purchase Account and credit Vendors' Account with the agreed purchase price.

2. Open Asset Accounts with debit balances, the combined value of these being credited to the Business Purchase Account. The Cash Book will be debited with any cash taken over.

3. Open similar accounts for liabilities, the total of these being debited to the Business Purchase Account.

4. If shares are issued to the vendors, debit their account and credit Share Capital Account with the value of the shares allotted. The Cash Book will be credited and the Vendors' Account debited with the cash balance of the purchase consideration (if any) when this is paid.

EXAMPLE 1. The following was the Balance Sheet of X and Y as at 31st December, 19..—

BALANCE SHEET

Liabilities	£	*Assets*	£
Creditors	2,000	Cash	400
		Debtors	3,000
Capital Accounts—		Stock	3,100
X	5,000	Plant	2,500
Y	4,000	Buildings	2,000
	£11,000		£11,000

On 1st January a limited company was formed to take over the business, with a registered capital of 25,000 £1

Ordinary shares. The purchase consideration was agreed at £12,000—£10,000 in shares, £1,000 in cash and the balance to be paid in one year from the date of the incorporation of the company. The company issued on the 10th January, 10,000 shares for public subscription on the following terms—

2s. 6d. on application.
7s. 6d. on allotment.
10s. one month after allotment.

The whole issue was fully subscribed and allotted on the 26th January, but in respect of the call due, £4,900 only was received. Show the Journal entries necessary to record the above transactions, the Ledger Accounts, and the opening Balance Sheet of the new company.

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				£	£
19..					
Jan.	1	Vendors' Account . . . *Dr.*		2,000	
		To Creditors			2,000
		Being the liabilities taken over by the company.			
		Cash . . . . . . *Dr.*		400	
		Debtors . . . . . *Dr.*		3,000	
		Stock . . . . . *Dr.*		3,100	
		Plant . . . . . *Dr.*		2,500	
		Buildings . . . . . *Dr.*		2,000	
		Goodwill . . . . . *Dr.*		3,000	
		To Vendors' Account . .			14,000
		Being the assets taken over by the company.			
	10	Application and Allotment A/c *Dr.*		1,250	
		To Share Capital Account .			1,250
		Being 2s. 6d. per share due on 10,000 shares offered for public subscription.			
	26	Application and Allotment A/c *Dr.*		3,750	
		To Share Capital Account .			3,750
		Being 7s. 6d. per share due on 10,000 shares allotted to sundry applicants.			
		Vendors' Account . . . *Dr.*		10,000	
		To Share Capital Account .			10,000
		Being 10,000 fully paid shares allotted to the vendors (X and Y) as part purchase consideration.			

Continued on next page

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Feb. 26	Call Account . . . *Dr.* To Share Capital Account . Being the first and final call of 10s. per share on 10,000 shares allotted.	5,000	5,000

Dr. APPLICATION AND ALLOTMENT ACCOUNT *Cr.*

19..		£	19..		£
Jan. 10	To Share Capital A/c .	1,250	Jan. 10	By Cash . . .	1,250
26	,, ,, ,, ,, .	3,750	26	,, ,, . . .	3,750
		£5,000			£5,000

Dr. CALL ACCOUNT *Cr.*

19..		£	19..		£
Feb. 26	To Share Capital A/c .	5,000	Feb. 26	By Cash . . .	4,900

Dr. SHARE CAPITAL ACCOUNT *Cr.*

19..		£	19..		£
			Jan. 10	By Application and Allotment Account	1,250
			26	,, Application and Allotment Account	3,750
				,, Vendors' Account .	10,000
			Feb. 26	,, Call Account . .	5,000

Dr. VENDORS' ACCOUNT (X AND Y) *Cr.*

19..		£	19..		£
Jan. 1	To Creditors . .	2,000	Jan. 1	By Sundry Assets .	14,000
10	,, Share Capital A/c .	10,000			
	,, Cash . . .	1,000			

Dr. DEBTORS' ACCOUNT *Cr.*

19..		£	19..		£
Jan. 1	To Vendors' Account .	3,000			

Dr. STOCK ACCOUNT *Cr.*

19..		£	19..		£
Jan. 1	To Vendors' Account .	3,100			

Dr. PLANT ACCOUNT *Cr.*

		£			£
19.. Jan. 1	To Vendors' Account .	2,500	19..		

Dr. BUILDINGS ACCOUNT *Cr.*

		£			£
19.. Jan. 1	To Vendors' Account .	2,000	19..		

Dr. GOODWILL ACCOUNT *Cr.*

		£			£
19.. Jan. 1	To Vendors' Account .	3,000	19..		

Dr. CREDITORS' ACCOUNT *Cr.*

		£			£
19..			19.. Jan. 1	By Vendors' Account .	2,000

Dr. CASH BOOK *Cr.*

		£			£
19.. Jan. 1	To Balance . . .	400	19.. Jan. 10	By Vendors' Account .	1,000
10	,, Application and Allotment Account	1,250			
26	,, Application and Allotment Account	3,750			
Feb. 26	,, Call Account . .	4,900			

EX & WYE, LTD.

(Opening Balance Sheet)

Liabilities		£	*Assets*	£
Nominal Capital—			Goodwill	3,000
25,000 £1 Ordinary Shares .		25 000	Buildings	2,000
Issued Capital—			Plant	2,500
20,000 £1 Ordinary Shares fully paid .	£20,000		Debtors	3,000
Less Calls in Arrear .	100		Stock	3,100
		19,900	Cash	9,300
Creditors		2,000		
Vendors (X and Y) . . .		1,000		
		£22,900		£22,900

Note. In practice, separate Ledger accounts would be opened for the individual debtors and creditors.

Profit or Loss Prior to Incorporation.

It is not uncommon for a company to be promoted to take over the business of an existing concern from a date before that of its own incorporation; for example, a company registered on the 1st April may acquire the business of the vendor as from the 31st December of the previous year. The main reason for this is because the last Balance Sheet of the business to be acquired forms a convenient basis of valuation and thus the necessity of preparing other final accounts is avoided. The profit made during those months before the new company comes into existence is generally included in the purchase price and, therefore, belongs to the new company. But it is not a *trading* profit and should not be included as such in the new company's accounts, because how can a company earn profit before it legally commences business? Profit acquired in this manner is therefore a capital profit and cannot be distributed to the shareholders, for to do so would amount to the payment of a dividend out of capital. Instead, it is transferred to a special Capital Reserve Account and used to write down some wasting asset or goodwill. To apply this *profit* to the reduction of preliminary expenses is considered by some accountants to be inadvisable. They argue that the company is excused the necessity of discharging such a debt from the subsequent trading profits, but carried to its logical conclusion, this contention applies equally to cases where goodwill or any wasting asset is written down, as subsequent profit made by the new company is relieved from the necessity of providing for depreciation.

At the close of the first financial or trading year, it will be necessary to divide the profit of the company made during this period into two parts; that made before and that made after its incorporation. Apportionment will be made on an equitable basis and suited to the particular type of business. The principal methods in practice are—

(*a*) On the basis of the turnover; and

(*b*) On the basis of time.

EXAMPLE 2. A company was incorporated on the 1st April to acquire a business from the previous 30th November.

The trading of the first year resulted in a profit of £6,000, the turnover for the period December to March being £10,000, and for the remaining eight months, £40,000. Apportion the profit made before and after the company's incorporation.

(*a*) *Turnover Basis.* This gives the profit before incorporation as ten-fiftieths of £6,000, which is £1,200, leaving £4,800 as the company's actual profit available for distribution.

(*b*) *Time Basis.* Allocated by this method, the profit before incorporation is four-twelfths of £6,000, which is £2,000, leaving £4,000 profit available for distribution.

Many authorities consider the *turnover* basis to be the better of the two, it being argued that the trade of a company may fluctuate, with the result that where the acquisition occurs during a normally slack period, the profit as shown by the *time* basis would hardly portray the real position. The circumstances of each particular case should, therefore, be taken into account before the basis of apportionment is fixed. With a view to avoiding any misleading impressions which are likely to arise as a result of the operation of either of the two foregoing methods, a combination of *both* methods is probably widely adopted. Under this method the gross profit is apportioned according to turnover, and the expenses allocated according to time.

Where the trading before the new company's formation has resulted in a loss, this should be treated as an addition to the purchase price. There are two ways in which it may be dealt with. Firstly, the loss may be added to any goodwill purchased or, if there is no goodwill already existing, an account under this heading may be opened, to which is transferred the calculated pre-incorporation loss. Secondly, the loss may be posted to a Suspense Account. In either case, however, a gradual elimination of the loss should be made by periodically charging a proportion to profit. Objection, however, is taken by many to the charging of such a loss in this manner, it being contended that profit made by the new company should in no way be burdened with a loss for which it was not responsible. It is further argued that as a profit made in such circumstances is considered as a capital one, so also should any loss

made be similarly regarded. Despite these arguments it would seem desirable, if only to strengthen the financial position of the company, to write off any pre-incorporation loss over a period of years.

Dividends.

The manner and method of distributing the profit of a company in the form of dividends will be set out in the Articles of Association. For this reason, it is possible only to generalize and to take as a basis for discussion the provisions of Table A, a summary of which is as follows—

1. The company in general meeting may declare a dividend, but no dividend shall exceed that recommended by the directors.
2. The directors may pay such interim dividends as appear to be justified by profits and trading prospects.
3. No dividend shall be paid otherwise than out of profit.
4. The directors may, before making any recommendation, set aside out of profit such sums that they deem proper, as a reserve to provide against future contingencies.

From the foregoing it appears that the most important point, as far as the accounts are concerned, is that "dividends may be paid only from profits." But, since the term "profit" covers a rather wide scope, it is necessary to determine what is "divisible profit." That the Profit and Loss Account of a company at the end of its trading year shows a substantial credit balance is *prima facie* evidence that a dividend can be paid. It is not, however, conclusive. If, during the particular period under review, the value of the assets had considerably decreased, the directors would be justified in making good any loss by means which they consider proper and necessary to maintain the company's financial security. Further, the directors might also deem it advisable to transfer part of the profit to a reserve, with a view to safeguarding the company's future. It would seem, therefore, in the absence of specific provision in the company's Articles, that divisible profits may be defined as "the excess of current income over current expenditure after wastage or loss in the value

of assets has been taken into account." That this definition is a wide one and perhaps open to criticism is admitted, but it must suffice. In the space available, it is not possible to deal exhaustively with the question, for any decision must, to no little extent, be arrived at only after a consideration of the various court judgments, and of the provisions of the company's Articles of Association.

Although there must be a *bona fide* profit before a dividend can be paid, Section 54 of the Companies Act, 1929, sanctions the payment of *interest out of capital.* In the ordinary way, a dividend is payable from a surplus which arises as the result of trading, but where the capital of the company is employed in such a manner that an immediate return is impossible, namely, in circumstances of the construction of buildings and factories, interest may be paid to the shareholders. The conditions attaching to this payment are—

1. It must be authorized by the Articles or by special resolution and be sanctioned by the Board of Trade.
2. The period during which payment is made may be determined by the Board of Trade and shall in no case extend beyond the close of the half-year next after the half-year during which the work was completed.
3. It shall not be more than 4 *per cent or such other rate*[1] as prescribed by Order in Council.
4. It shall not operate as a reduction of the amount paid up on the shares in respect of which it is paid.
5. The accounts of the company must show the share capital on which, and the rate at which, the interest has been paid.

There is another exception to the rule that dividends may only be paid out of profit, i.e. interest on calls paid in advance.

Deduction of Tax.

Except where a dividend is declared *free of tax,* the company must deduct income tax at the full standard rate in force for the year in which the dividend payable becomes due.

[1] At the time of writing this is 6 per cent.

To make shares and debentures appear as a favourable investment, it is sometimes customary for the company to declare dividends tax free. This does not mean that no tax is payable on these dividends. But instead of the tax being deducted, the shareholder receives the gross amount and the company pays the tax itself. As a general rule, this practice of declaring dividends tax free is confined to ordinary or deferred shares, for, if preference shareholders were paid their fixed rate of dividend without deduction of tax, this would, in fact, amount to a dividend in excess of that prescribed by the Articles or by the terms under which the preference shares were issued.

Payment of Dividend.

No liability to pay a dividend arises until the directors' declaration is sanctioned by the shareholders, although the Articles usually empower the directors to pay interim dividends without first receiving the shareholders' approval.

Following sanction of the payment, a dividend list is prepared, giving particulars of the holding of each shareholder; the amount paid up on the shares; the gross amount of dividend due; the appropriate rate of tax, and the net amount payable. From this list the dividend warrants are next compiled, and these must show the gross and net amounts due and the tax deducted. Separate accounts are opened in the Ledger for dividends and income tax, and arrangements will be made with the company's bankers to open a special account for the dividend. The total amount of dividend payable (less tax, unless paid tax free) is transferred by the bank to this account from which the dividends are paid. Where dividends are declared on several classes of shares, a separate account is opened for each class. The Ledger entries necessary may be summarized as follows—

1. Debit Profit and Loss Appropriation Account and credit Dividend Account with the *full* amount of dividend declared.

2. Debit Dividend Account and credit Income Tax Account with the tax payable on the dividend. This is calculated at the full standard rate.

3. Debit Dividend Account and credit Cash (or Bank)

Account with the dividends when they are paid. A list of these will be obtained from the bankers.

4. Debit Income Tax Account and credit Cash (or Bank) Account when payment is made to the Inland Revenue authorities.

Unclaimed dividends are transferred to a special account, under which heading they will appear as a liability in the Balance Sheet. The corresponding balance of dividends unpaid in the special Dividend (bank) Account may be merged with the ordinary bank balance or may be separately disclosed in the Balance Sheet.

Arrears of dividend can arise only on those shares in respect of which a fixed rate is payable, namely, on cumulative preference shares. Although no liability can arise until sufficient profit has been made, there is, in fact, a contingent liability, in so far as the holders of such shares have a prior right to the profit first available for distribution. A note, referring to the arrears of dividend, is sometimes appended to the Balance Sheet.

Final Accounts.

The accounts kept by the limited company and the manner in which the Trading and Profit and Loss Accounts are compiled differ very little from those of the sole trader or partnership. The chief point of difference is that whereas the sole trader and partners are under no statutory obligation to keep proper books and accounts, the limited company is compelled by law to do so. The nature of the adjustments made in company accounts is also a little different. Such items as transfers to reserve, payment of dividends and debenture interest, reserve for income tax, pensions funds, and others which do not enter into partnership accounts are, in the main, recorded by means of an Appropriation Account. Another important point of distinction is the inclusion of the profit and loss balance in the final accounts. The profit disclosed by the accounts of a sole trader or a partnership is added to the respective Capital (or Current) Accounts, but as the capital of a company is fixed, the balance of profit not

distributed appears in the Balance Sheet as a separate item. The particulars which a company is now bound to give in its accounts were given in Chapter IV under "Statistical Books." The examples which follow may be taken as a general illustration of the form of the Trading and Profit and Loss Accounts and Balance Sheet of a limited company.

EXAMPLE 3. From the following Trial Balance of the accounts of a manufacturing company whose authorized capital consists of 15,000 Ordinary shares of £10 each, prepare a Trading and Profit and Loss Account for the year ended 31st December, 19.., and a Balance Sheet as on that date.

	£	£
Issued Capital, 9,000 shares fully paid		90,000
Stock, 1st January	32,000	
Cash in Hand	150	
Cash at Bank	2,900	
Purchases and Sales	52,350	136,500
Returns	400	750
Manufacturing Charges	11,500	
Wages	28,550	
Salaries	1,500	
Trade Expenses	6,850	
Rates and Taxes	250	
Insurance	190	
General Expenses	2,640	
Discounts	1,800	
Bad Debts	770	
Bank Charges	150	
Land and Buildings	22,300	
Machinery and Plant	35,600	
Sundry Debtors and Creditors	52,500	21,800
Patents	5,000	
Bad Debts Reserve, 1st January		2,600
Profit and Loss (balance), 1st January		750
Reserve		5,000

Charge depreciation on Land and Buildings at 3 per cent, on Machinery and Plant at 6 per cent, and on Patents at 10 per cent. Make a reserve of 5 per cent on the Sundry Debtors; carry forward £90 of Insurance, and charge £500 as Directors' Fees. Charge also 10 per cent on net profits as remuneration to the Managing Director, and appropriate

£2,500 to the Reserve Fund. The value of stock as on 31st December, 19.., was agreed at £23,700.

The solution to this example will be found on pages 154 and 155.

EXAMPLE 4. The Blankshaw Trading Co., Ltd., was registered with a nominal capital of £100,000 divided into 10,000 6 per cent Preference shares of £5 each and 50,000 Ordinary shares of £1 each. From the following Trial Balance prepare a Trading and Profit and Loss Account for the year ended 30th June, 19.., and a Balance Sheet as on that date.

Issued Capital—	£	£
40,000 Ordinary shares fully paid		40,000
8,000 Preference shares fully paid		40,000
5 per cent Debentures		10,000
Land and Buildings	35,000	
Plant	28,000	
Furniture and Fittings	750	
Investments	3,500	
Reserve Fund		5,000
Cash at Bank	9,068	
Cash in Hand	230	
Stock, 1st July	29,701	
Sundry Debtors and Creditors	21,600	12,769
Purchases and Sales	45,850	90,284
Returns	204	650
Wages	8,756	
Manufacturing Expenses	2,000	
Salaries	1,800	
Carriage	2,051	
Rates and Taxes	640	
Insurance	250	
Debenture Discount	1,000	
Directors' Fees	2,000	
Preliminary Expenses	1,500	
Sundry Expenses	782	
Bank Interest (less charges)		106
Discounts (balance)	152	
Bad Debts	490	
Debenture Interest	250	
Preference share dividend paid	2,050	
Ordinary share interim dividend paid	1,400	
Profit and Loss balance, 1st July		2,615
Travellers' Commission and Expenses	2,400	
	£201,424	£201,424

Before preparing the necessary accounts, the following adjustments must be made—

(*a*) Depreciate Buildings, 3 per cent.
Plant, 10 per cent.
Furniture, 10 per cent.

(*b*) Provide a reserve for Bad Debts of 5 per cent on Sundry Debtors.

(*c*) Reserve 5 per cent on Sundry Debtors for Discount.

(*d*) Insurance has been prepaid £50, and Rates due amount to £100.

(*e*) Interest due from Investments amount to £200, and half-year Debenture Interest is also due to be paid.

(*f*) Appropriate £2,000 to Reserve.

(*g*) Write off one-quarter of the Debenture Discount, and one-quarter of the Preliminary Expenses.

(*h*) The value of Stock at 30th June, 19.., was £20,655.

The solution to this example will be found on pages 156 and 157.

Consolidation and Division of Shares.

Under Section 50 of the Companies Act, 1929, a company may, by ordinary resolution, consolidate or divide its shares. The total amount of the capital remains unchanged as a result of either process, the nominal value of the shares being increased or decreased according to the resolution adopted. A schedule of the members of the company should be prepared, showing the old and new capital held by each member. It will, of course, also be necessary to compile a new Register of Members.

			£	£
	Preference Share Capital (£1) Account . . . . *Dr.*		50,000	
	To Preference Share Capital (£10) Account			50,000
	Being the conversion of 50,000 Preference Shares of £1 each into 5,000 shares of £10 each, in accordance with resolution dated 19			

If a company with a Preference share capital of 50,000 £1 shares decides to consolidate this into 5,000 shares of £10 each, the old Capital Account is substituted by a new one, the Journal entry (as shown on page 152) being made to effect the transfer.

The alteration in the division of capital by creating a larger number of shares of a smaller denominational value is dealt with in a similar manner.

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			£	£
	Ordinary Share Capital (£1) Account . . . . *Dr.*		20,000	
	To Ordinary Share Capital (5s.) Account			20,000
	Being the conversion of 20,000 Ordinary shares of £1 each into 80,000 shares of 5s. each in accordance with resolution dated . . .. . 19 . ..			

Whichever method is adopted, notice of an alteration in the constitution of the capital must be filed with the Registrar of Companies.

Reduction of Capital.

The main reason for the reduction of capital is generally due to the accumulation of a large debit balance in the Profit and Loss Account or to the non-provision over a number of years for loss in value of assets, either of which causes may render it necessary for the company in such circumstances to seek ways and means of improving the face value of its Balance Sheet. Where the sole trader or partnership experiences a series of unprofitable years, any loss may be charged to the individual Capital (or Current) Accounts, but this is not possible in the case of the limited company in which the capital cannot be varied by the profit or loss made.

The directors first prepare a scheme setting forth the particulars of the proposed reduction which, after receiving the sanction of the shareholders (and, if necessary, the creditors).

TRADING AND PROFIT AND LOSS ACCOUNT

FOR THE YEAR ENDED 31ST DECEMBER, 19..

Dr.					*Cr.*
	£	£		£	£
To Stock, 1st January		32,000	By Sales	136,500	
,, Purchases	52,350		*Less* Returns	400	
Less Returns	750				136,100
		51,600	,, Stock, 31st December		23,700
,, Manufacturing Charges		11,500			
,, Wages		28,550			
,, Gross Profit c/d		36,150			
		£159,800			£159,800
To Salaries		1,500	By Gross Profit b/d		36,150
,, Trade Expenses		6,850			
,, Rates and Taxes		250			
,, Insurance		100			
,, General Expenses		2,640			
,, Discount		1,800			
,, Bad Debts		770			
,, Bank Charges		150			
,, Bad Debts Reserve		25			
,, Depreciation—					
Buildings	669				
Machinery and Plant	2,136				
Patents	500				
		3,305			
,, Directors' Fees		500			
Net Profit c/d		18,260			
		£36,150			£36,150
To Managing Director's Remuneration		1,826	By Net Profit b/d		18,260
,, Reserve Fund		2,500	,, Balance from last Account		750
,, Balance carried forward		14,684			
		£19,010			£19,010

BALANCE SHEET

As at 31st December, 19..

Liabilities	£	£	*Assets*	£	£
Nominal Capital—			Land and Buildings	22,300	
15,000 £10 Ordinary Shares		150,000	*Less* Depreciation	669	
					21,631
			Machinery and Plant	35,600	
Issued Capital—			*Less* Depreciation	2,136	
9,000 £10 Ordinary Shares					33,464
fully paid		90,000	Patents	5,000	
Sundry Creditors—			*Less* Depreciation	500	
Trade	21,800				4,500
Managing Director's Remunera-			Sundry Debtors	52,500	
tion	1,826		*Less* Bad Debts Reserve	2,625	
Directors' Fees	500				49,875
		24,126	Stock		23,700
Reserve Fund	5,000		Cash at Bank		2,900
Add Appropriation	2,500		Cash in Hand		150
		7,500	Insurance paid in Advance		90
Profit and Loss Account		14,684			
		£136,310			£136,310

THE BLANKSHAW TRADING CO., LTD.

Dr. TRADING AND PROFIT AND LOSS ACCOUNT FOR THE YEAR ENDED 30TH JUNE, 19.. *Cr.*

	£	£		£	£
To Stock, 1st July		29,701	By Sales	90,284	
,, Purchases	45,850		*Less* Returns	204	
Less Returns	650				90,080
		45,200	,, Stock, 30th June		20,655
,, Manufacturing Expenses		2,000			
,, Wages		8,756			
,, Gross Profit c/d		25,078			
		£110,735			£110,735
To Salaries		1,800	By Gross Profit b/d		25,078
,, Travellers' Commission, etc.		2,400	,, Bank Interest		106
,, Directors' Fees		2,000	,, Investment Interest		200
,, Rates and Taxes		740			
,, Insurance		200			
,, Carriage		2,051			
,, Sundry Expenses		782			
,, Discount		152			
,, Bad Debts		490			
,, Bad Debts Reserve		1,080			
,, Discount Reserve (5% on Debtors, £20,520)		1,026			
,, Debenture Interest		500			
,, Depreciation—					
Buildings, 3%	1,050				
Plant, 10%	2,800				
Furniture, 10%	75				
		3,925			
,, Debenture Discount		250			
,, Preliminary Expenses		375			
,, Net Profit c/d		7,613			
		£25,384			£25,384
To Preference Share Dividend	2,050		By Net Profit b/d		7,613
,, Ordinary Share Interim Dividend	1,400		,, Balance, 1st July		2,615
		3,450			
,, Reserve Fund		2,000			
,, Balance carried forward		4,778			
		£10,228			£10,228

THE BLANKSHAW TRADING CO., LTD.

BALANCE SHEET AS AT 30TH JUNE, 19..

Liabilities	£	£	*Assets*	£	£
Nominal Capital—			Land and Buildings		33,950
10,000 6% Preference Shares			Plant and Machinery		25,200
of £5 each		50,000	Furniture and Fittings		675
50,000 Ordinary Shares of £1			Investments		3,500
each		50,000	Stock		20,655
			Sundry Debtors	21,600	
Issued Capital—			*Less* Bad Debts Reserve	1,080	
8,000 Preference Shares fully					
paid	40,000			20,520	
40,000 Ordinary Shares fully			*Less* Discount Reserve	1,026	
paid	40,000				19,494
		80,000	Cash at Bank	9,068	
5 per cent Debentures		10,000	Cash in Hand	230	
Sundry Creditors—					9,298
Trade	12,769		Debenture Discount		750
Rates	100		Preliminary Expenses		1,125
Debenture Interest	250		Investment Interest		200
		13,119	Insurance		50
Reserve Fund		7,000			
Profit and Loss Account		4,778			
		£114,897			£114,897

is placed before the Court for official ratification. A special resolution must be passed to alter the Articles where they do not already authorize the reduction in capital. The most common form of the reduction is for each share to have a proportionate part of the paid-up amount thereon written off. A Capital Reduction Account is opened, through which the entries are passed preparatory to the adjustment of the Capital and Asset Accounts in the Ledger.

EXAMPLE 5. The following is the Balance Sheet of the X. Y. Z. Co., Ltd., as at 31st December, 19..—

Liabilities	£	*Assets*	£
Nominal Capital—		Premises . . .	40,000
50,000 £1 Pref. Shares	50,000	Plant and Fixtures .	13,000
50,000 £1 Ord. Shares	50,000	Patents . . .	10,000
		Stock	15,000
Issued Capital—		Debtors . . .	12,750
50,000 Pref. Shares		Cash	2,000
fully paid . .	50,000	Profit and Loss balance	15,250
50,000 Ord. Shares			
fully paid . .	50,000		
Creditors . . .	8,000		
	£108,000		£108,000

The company decided, in general meeting, to reduce both classes of shares by 5s. a share, to be applied as follows—

	£
Profit and Loss Account . .	15,250
Premises	4,000
Plant and Fixtures . . .	3,750
Patents	2,000

Make the necessary Journal entries and draw up the new Balance Sheet.

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			£	£
	Preference Share Capital A/c *Dr.*		12,500	
	To Capital Reduction Account .			12,500
	Being 50,000 Preference Shares of £1 fully paid reduced to 50,000 Shares of 15s. each, as per resolution dated 19			

(*Continued on the next page*)

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		£	£
Ordinary Share Capital A/c . *Dr.*		12,500	
To Capital Reduction Account .			12,500
Being 50,000 Ordinary shares of £1 fully paid reduced to 50,000 shares of 15s. each, as per resolution dated 19 .			
Capital Reduction Account . *Dr.*		25,000	
To Profit and Loss Account .			15,250
,, Premises Account . . .			4,000
,, Plant and Machinery Account			3,750
,, Patents Account . . .			2,000
Being amounts written off, as per resolution dated . 19 .			

THE X. Y. Z. CO., LTD., AND REDUCED

Liabilities	£	*Assets*	£
Nominal Capital—		Premises	36,000
50,000 £1 Pref. Shares reduced, by order of the Court, to 15s. each	37,500	Plant and Fixtures .	9,250
50,000 £1 Ord. Shares reduced, by order of the Court, to 15s. each	37,500	Patents	8,000
Issued Capital—		Stock	15,000
50,000 Pref. Shares as above	37,500	Debtors	12,750
50,000 Ord. Shares as above	37,500	Cash	2,000
Creditors	8,000		
	£83,000		£83,000

After the entries have been passed through the books, new share certificates will be prepared and issued on the surrender of the old share certificates, the Register of Members and Shareholders' Accounts being altered accordingly. Before the passing of the Companies Act, 1929, the Court generally enforced the order that the words "*and Reduced*" be included after the name or style of the company, but the new Act allows the Court to exercise its discretion in this respect.

Capitalization of Profit.

A number of profitable years may have enabled the directors to build up a large reserve fund from appropriations of profit and, if the present conditions and future trading prospects are favourable, the directors may return this reserve to the shareholders of the concern in the shape of bonus or free shares. This is, in effect, the capitalization of profit, a step which requires very careful consideration, since, though the profit-earning capacity of the company is in no way affected, the share capital on which dividend is payable is increased by the number of bonus shares offered. This means that if only the same profit is earned in subsequent years, the rate of dividend will be reduced.

The Articles of the company must authorize the capitalization of the reserve, and the issue of shares must be sanctioned by the company in general meeting, a return of allotments being lodged with the Registrar in the usual way. In addition, it will again be necessary to adjust the Register of Members and the Shareholders' Accounts.

EXAMPLE 6. The Waldingham Manufacturing Co., Ltd., with a share capital of 50,000 £1 shares and a reserve account of £15,000 decided to distribute part of the reserve in bonus shares at the rate of one fully-paid share for every eight shares already held. Give the Journal entries necessary to record the issue of bonus shares.

			£	£
	Reserve Account . . . *Dr.* To Bonus Account . . . Being bonus payable out of Reserve in fully paid shares, as per resolution dated . 19		6,250	6,250
	Bonus Account . . . *Dr.* To Share Capital Account . . Being issue of 6,250 Bonus shares of £1 each fully paid in payment of bonus, at the rate of one bonus share for every eight shares held in the company, as per resolution dated . . . 19 .		6,250	6,250

The effect of these entries on subsequent Balance Sheets will be obvious; part of the reserve being transferred to, and becoming part of, the capital of the company.

Amalgamation.

With a view to reducing the costs of production and, to some extent, eliminating competition, it is not unusual for companies engaged in the same type of business to merge or to amalgamate. The entries in the financial books which will, of course, vary with the conditions of amalgamation, are very similar to those applying to the conversion of a partnership into a limited company. The books of the individual concerns are closed, and the entries then made in the accounts of the new company depend on which of the three following forms is adopted—

1. Amalgamation by the formation of a new company.
2. Amalgamation by the creation of a "holding" company.
3. Amalgamation by absorption.

Where a new company is formed to take over the assets of existing companies it is usual for the shareholders of the latter to receive fully paid shares in the new company and/or cash. As soon as the shareholders' approval is secured, liquidators are appointed to supervise the transfer of the assets and the payment of the purchase consideration, which may consist of fully paid shares or partly of shares and partly of cash. All asset and liability accounts in the books of the old companies are closed by means of the following entries—

1. Debit a Business Realization Account with the assets acquired and credit it with the liabilities transferred.

2. Open an account for the new company; debit this and credit the Business Realization Account with the purchase consideration. Any balance in the latter account, which represents either a profit or a loss on the disposal of the business, is transferred to a Sundry Shareholders' Account.

3. Open a Shares Account; debit this and credit the new company's account with the nominal value of the shares received from the new company.

4. Close the Share Capital Account (of the old concern/s)

and Reserve Account (if any) by transferring the balances to a Sundry Shareholders' Account.

5. Close the Shares Account by transferring its balance to the Sundry Shareholders' Account.

The opening entries to be made in the books of the new company are as follows—

1. Open individual accounts for the assets and liabilities taken over, crediting and debiting a Business Purchase Account respectively with the values of the assets and liabilities.

2. Open a Liquidator's Account for each of the vendor companies; credit these accounts and debit the Business Purchase Account with the purchase consideration.

3. Debit the Liquidators' Accounts with the shares, debentures, and cash which comprise the purchase consideration.

4. Any balance of the Business Purchase Account, which will arise where the total assets taken over exceed the liabilities plus the purchase price, must be transferred to a Capital Reserve Account, which is debited with the preliminary and other formation expenses. The final balance of the Capital Reserve Account will appear in the new company's Balance Sheet as a separate item.

EXAMPLE 7. The Black Co., Ltd., and the White Co., Ltd., decide to amalgamate and form a new company to be registered as Black & White, Ltd., with a capital of 250,000 £1 shares, which is to acquire the respective undertakings of the two separate concerns. The balance sheets of the vendor companies at the date of the amalgamation were as follows—

BLACK CO., LTD.

Liabilities	£	*Assets*	£
Issued Share Capital	100,000	Buildings	55,000
Reserve	10,000	Plant	16,400
Creditors	5,450	Stock	23,750
		Debtors	10,600
		Cash and Bank	9,700
	£115,450		£115,450

WHITE CO., LTD.

Liabilities	£	*Assets*	£
Issued Share Capital .	80,000	Buildings . . .	35,500
Creditors . . .	15,980	Plant . . .	15,000
		Fittings . . .	1,500
		Investments . .	5,000
		Stock . . .	15,680
		Debtors . . .	18,200
		Cash and Bank . .	5,100
	£95,980		£95,980

The terms on which the amalgamation is to take place are outlined below—

1. The new company is to take over the whole of the assets and liabilities of both companies.

2. Black Co., Ltd., is to be allotted 100,000 fully-paid shares of £1 each and to be paid £10,000 in cash.

3. White Co., Ltd., is to be allotted 75,000 fully-paid shares of £1 each.

4. The new company is to pay the liquidation expenses of the Black Co., Ltd. (£1,050), and of the White Co., Ltd. (£850).

5. The formation expenses of the new company amounted to £1,470.

Show the closing entries in the books of the old companies, and the opening entries and Balance Sheet of Black & White, Ltd.

Books of Black Co., Ltd.

Dr. BUSINESS REALIZATION ACCOUNT *Cr.*

		£			£
	To Sundry Assets .	115,450		By Creditors . .	5,450
				,, Black & White .	110,000
		£115,450			£115,450

Dr. BLACK & WHITE, LTD. *Cr.*

		£			£
	To Business Realization Account .	110,000		By Shares Account .	100,000
				,, Cash . . .	10,000
		£110,000			£110,000

Dr. SHARES ACCOUNT *Cr.*

		£			£
	To Black & White .	100,000		By Sundry Shareholders' Account	100,000

Dr. SHARE CAPITAL ACCOUNT *Cr.*

		£			£
	To Sundry Shareholders' Account	100,000		By Balance b/d .	100,000

Dr. RESERVE ACCOUNT *Cr.*

		£			£
	To Sundry Shareholders' Account	10,000		By Balance b/d .	10,000

Dr. SUNDRY SHAREHOLDERS' ACCOUNT *Cr.*

		£			£
	To Shares Account .	100,000		By Share Capital .	100,000
	,, Cash . . .	10,000		,, Reserve . .	10,000
		£110,000			£110,000

Books of White Co., Ltd.

Dr. BUSINESS REALIZATION ACCOUNT *Cr.*

		£			£
	To Sundry Assets .	95,980		By Creditors . .	15,980
				,, Black & White .	75,000
				,, Sundry Shareholders' Account	5,000
		£95,980			£95,980

Dr. BLACK & WHITE, LTD. *Cr.*

		£			£
	To Business Realization Account .	75,000		By Shares Account .	75,000

Dr. SHARES ACCOUNT *Cr.*

		£			£
	To Black & White .	75,000		By Sundry Shareholders' Account	75,000

Dr. SHARE CAPITAL ACCOUNT *Cr.*

		£			£
	To Sundry Shareholders' Account	80,000		By Balance b/d .	80,000

Dr. SUNDRY SHAREHOLDERS' ACCOUNT *Cr.*

		£			£
	To Shares Account .	75,000		By Share Capital .	80,000
	,, Business Realization Account .	5,000			
		£80,000			£80,000

Books of Black & White, Ltd.

Dr. BUSINESS PURCHASE ACCOUNT *Cr.*

		£			£
	To Creditors—			By Buildings . .	90,500
	Black Co., Ltd. .	5,450		,, Plant . . .	31,400
	White Co., Ltd. .	15,980		,, Fittings . .	1,500
	,, Agreed Purchase Consideration—			,, Investments .	5,000
	Black Co., Ltd. .	110,000		,, Stock . . .	39,430
	,, White Co., Ltd. .	75,000		,, Debtors . .	28,800
	,, Capital Reserve Account . .	5,000		,, Cash . . .	14,800
		£211,430			£211,430

Dr. LIQUIDATOR OF BLACK CO., LTD. *Cr.*

		£			£
	To Share Capital A/c	100,000		By Business Purchase Account .	110,000
	,, Cash . . .	10,000			
		£110,000			£110,000

Dr. LIQUIDATOR OF WHITE CO., LTD. *Cr.*

	To Share Capital A/c	£ 75,000		By Business Purchase Account . .	£ 75,000

Dr. SHARE CAPITAL ACCOUNT *Cr.*

		£			£
				By Liquidator of—	
				Black Co., Ltd. .	100,000
				White Co., Ltd. .	75,000

Dr. CAPITAL RESERVE ACCOUNT *Cr.*

		£			£
	To Cash—			By Business Purchase Account . .	5,000
	Liquidation Expenses—				
	Black Co., Ltd.	1,050			
	White Co., Ltd	850			
	,, Preliminary Expenses . .	1 470			
	, Balance c/d .	1,630			
		£5,000			£5,000
				By Balance b/d .	1,630

Dr. SUNDRY ASSETS (EXCLUDING CASH) *Cr.*

		£			
	To Business Purchase Account—				
	Black Co., Ltd. .	105,750			
	White Co., Ltd. .	90,880			

Dr. SUNDRY CREDITORS *Cr.*

		£			£
				By Business Purchase Account—	
				Black Co., Ltd. .	5,450
				White Co., Ltd. .	15,980

Dr. CASH BOOK *Cr.*

		£			£
	To Transfers from—			By Liquidator of	
	Black Co., Ltd. .	9,700		Black Co., Ltd. .	10,000
	White Co., Ltd. .	5,100		,, Capital Reserve Account: Liquidation Expenses–	
				Black Co., Ltd.	1,050
				White Co., Ltd.	850
				,, Preliminary Expenses . .	1,470
				,, Balance c/d .	1,430
		£14,800			£14,800
	To Balance b/d .	1,430			

BLACK & WHITE, LTD.

Opening Balance Sheet

Liabilities	£	*Assets*	£
Nominal Capital—		Buildings . . .	90,500
250,000 shares of £1 each . . .	250,000	Plant . . .	31,400
		Fittings . . .	1,500
		Investments . .	5,000
Issued Capital—		Stock . . .	39,430
175,000 shares of £1 each fully paid .	175,000	Debtors . . .	28,800
Capital Reserve A/c .	1,630	Cash . . .	1,430
Creditors . . .	21,430		
	£198,060		£198,060

The second method requires very little adjustment in the accounts. A new company is formed (afterwards called the "holding company") which acquires a sufficient number of shares in another company or companies to obtain a controlling interest. An investment account is opened in the books of the purchasing company headed "Shares in —— Co., Ltd.," which is debited with the cost of the shares purchased, the contra entry appearing on the credit side of the Cash Book. The balance of this investment account will be shown in the Balance Sheet as an asset.

The financial books of the company whose shares are purchased do not require adjustment, the only entries being those

necessary to effect the change in the ownership of the shares. The company will continue to trade independently, the holding company by a change of directorate obtaining control over the policy of the former. It is usual for the holding company to issue shares to provide itself with sufficient funds with which to carry out its objects, and the entries then necessary are exactly the same as those outlined in the previous chapter.

Amalgamation by absorption is similar to the first method, the chief difference being that, instead of the formation of a new company to take over two or more existing companies, absorption implies the merging of one company into another, whereby the existence of one entirely, or almost entirely, disappears. The books of the company to be absorbed are closed by means of a transfer to a Business Realization Account. Any "profit" on realization is transferred to a Sundry Shareholders' Account, and this, with the shares in the purchasing company, is distributed to the shareholders of the vendor company.

EXAMPLE 8. The Balance Sheet of the Manton Co., Ltd., as at 31st March, is as follows—

Liabilities	£	*Assets*	£
Issued Capital—		Premises	20,000
80,000 £1 shares	80,000	Plant	15,500
Creditors	7,915	Stock	34,500
		Debtors	12,810
		Cash	5,105
	£87,915		£87,915

The entire company is acquired by P. Jones, Ltd., the purchase consideration being the allotment of one fully-paid £1 share in P. Jones, Ltd., for eight shares of the Manton Co., Ltd., and a cash payment of £80,000. The liquidation expenses, to be borne by the vendor company, amounted to £1,050. Close the books of the vendor company, prepare a Realization Account, show the distribution of shares and cash, and give the opening entries in the accounts of P. Jones, Ltd.

Entries in books of the Manton Co., Ltd.

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		£	£
Realization Account . . *Dr.* To Sundry Assets . . . Being assets acquired by P. Jones, Ltd.		87,915	87,915
Creditors . . . . *Dr.* To Realization Account . . Being transfer of liabilities to P. Jones, Ltd.		7,915	7,915
P. Jones, Ltd. . . . *Dr.* To Realization Account . . Being purchase consideration.		90,000	90,000
Shares Account . . . *Dr.* Cash . . . . . *Dr.* To P. Jones, Ltd. . . . Being payment of purchase consideration.		10,000 80,000	90,000
Realization Account . . *Dr.* To Cash . . . . . . Being payment of liquidation expenses.		1,050	1,050
Share Capital Account . *Dr.* To Sundry Shareholders' Account Being transfer of balance of capital.		80,000	80,000
Realization Account . . *Dr.* To Sundry Shareholders' Account Being transfer of Realization profit.		8,950	8,950
Sundry Shareholders' Account *Dr.* To Shares Account . . . ,, Cash . . . . . Being distribution of 10,000 shares of P. Jones, Ltd., and cash at the rate of 19s. 8·85d. in the £ to sundry shareholders.		88,950	10,000 78,950

Dr. REALIZATION ACCOUNT Cr.

		£			£
	To Sundry Assets .	87,915		By Creditors . .	7,915
	,, Liquidation Expenses . .	1,050		,, P. Jones, Ltd. .	90,000
	,, Sundry Shareholders' Account	8,950			
		£97,915			£97,915

Dr. SUNDRY SHAREHOLDERS' ACCOUNT Cr.

		£			£
	To Shares Account (P. Jones, Ltd.) .	10,000		By Share Capital A/c	80,000
	,, Cash . . .	78,950		,, Realization A/c .	8,950
		£88,950			£88,950

Entries in books of P. Jones, Ltd.

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			£	£
	Premises . . . . . Dr.		20,000	
	Plant . . . . . Dr.		15,500	
	Stock . . . . . Dr.		34,500	
	Debtors . . . . . Dr.		12,810	
	Cash . . . . . . Dr.		5,105	
	Goodwill . . . . . Dr.		10,000	
	To Manton Co., Ltd. (Liquidator) Account			97,915
	Being assets acquired from Manton Co., Ltd.			
	Manton Co., Ltd. (Liquidator) Account . . . . . Dr.		7,915	
	To Creditors			7,915
	Being transfer of liabilities from Manton Co., Ltd.			
	Manton Co., Ltd. (Liquidator) Account . . . . . Dr.		90,000	
	To Share Capital Account .			10,000
	,, Cash			80,000
	Being payment of purchase consideration.			

6d. paid, and its issued 6 per cent Preference share capital is £100,000, 15s. paid. The company resolved to declare a bonus sufficient to clear the unpaid capital on both classes of shares. Appropriate calls were made and paid out of the bonus declared. Record the transactions in the Ledger Accounts of the company. (I.B.)

Y. A company which had suffered severe depreciation of its fixed assets, was reconstructed upon the following agreed terms—

(*a*) The shareholders to receive fully paid Ordinary shares equal to one-third of their present holding, and

(*b*) 6 per cent Preference shares to a similar amount.

(*c*) £50,000 7 per cent Second Debentures also to be allotted to the shareholders.

The existing issued Share Capital is £600,000 in fully paid £1 Ordinary shares. The Goodwill, standing in the books at £80,000, was to be completely written off; Freehold Premises to be written down by £20,000, and Plant and Equipment to be reduced from £150,000 to £100,000. First Debentures carrying interest at 6 per cent amounting to £50,000 were issued at a discount of 5 per cent, payment being received for them in full.

Show the Journal entries arising out of the above. (C.A.A.)

Z. The following is the Balance Sheet of the Carlton Co., Ltd., as on 31st December, 19..—

Liabilities	£	*Assets*	£
Nominal and Issued Capital—		Goodwill	20,000
50,000 £1 shares fully paid	50,000	Premises	25,000
Reserve Fund	15,000	Plant	5,000
Creditors	4,800	Stock	10,600
Profit and Loss Account	3,200	Debtors	7,450
		Cash and Bank	4,950
	£73,000		£73,000

With a view to reducing expenses of production and partially eliminating competition, the Denton Co., Ltd., agrees to take over the Carlton Co., Ltd., as from 1st January, 19.., on the following terms—

1. The Denton Co., Ltd., is to assume the liabilities and take over the assets at the above values.

2. The Denton Co., Ltd., is to pay the shareholders of the Carlton Co., Ltd., 5s. per share, and to give three 10s. shares in the Denton Co., Ltd., for every £1 share in the Carlton Co., Ltd.

You are required to close the books of the Carlton Co., Ltd., and to record the acquisition of the new business in the books of the Denton Co., Ltd.

CHAPTER VII

DEPARTMENTAL ACCOUNTS

THE gradual transition in the business and commercial world from the sole trader to the large departmental store has rendered it essential to design accounts in such a way that the trading results achieved by each section of the business can be ascertained. There is very little difference in the actual books or accounts kept, for a suitable system of departmental accounts involves merely the method of analysis applied to the fundamental rules of book-keeping, as a result of which, it is possible to calculate—

1. The gross or net profit (or loss) for each department; and
2. Any abnormal decrease or increase in sales, output, or expenditure.

In addition, valuable information and data collated over a number of years are available for comparative and statistical purposes.

When the business transactions of each department are large, it may be found that the use of analysis columns is cumbersome, and it then becomes necessary to keep separate books for each department to record its own operations. Further, the system will vary according to the nature of the information desired. If the calculation of only the *gross* profit is the object of the proprietors, all that is necessary is the dissection or allocation of those items usually found in the Trading Account. Where, however, the net profit for each section of the business has to be ascertained, all expenses and charges apart from the actual buying and selling dealings must be analysed and, consequently, the work involved is greater.

Gross Profit.

Stock must be taken for each department at the beginning and close of each financial year, and for this purpose, either

separate stock accounts are kept or analysis columns are used. The individual purchases and sales, purchases returns and sales returns, will be recorded by means of analysis-columned Day Books and Ledger accounts, of which specimens appear on page 186. Each department will keep a record of its wage cost or, if this is not possible, a general wages dissection book is used. Similarly, account will be kept of carriage and other productive expenses.

At each year-end, a schedule of stock, purchases, sales, returns, and carriage, etc., is prepared, and from these particulars the Departmental Trading Account can be compiled. This is, of course, the same as that customarily prepared, with the exception that columns are added on both sides for each department.

Net Profit.

The calculation of the *net* profit (or loss) made by each department renders the book-keeping slightly more complicated. The purchases and sales can be apportioned amongst the departments without much difficulty, but the allocation of expenditure which cannot definitely be charged to any particular section of the business calls for the operation of a method by means of which these expenses can be apportioned. Thus, the terms "direct" and "indirect" expenses arise. *Direct* expenses are those which can be identified with any section, process, or department; *indirect* expenses are those of a general nature which apply more to the whole business rather than to a section of it.

Some distinction is, therefore, necessary between these direct and indirect items. The former are charged at once to the department concerned, but the latter, as has been previously stated, must be allocated on such a basis, equitable in its application, to all those departments which derive benefit from the expense concerned. Each business will have its own particular method adjusted to meet individual requirements, so that the type and nature of the business are a very important factor when the proposed basis is under consideration. Indirect expenses may be apportioned on the basis of:

DEPARTMENTAL SALES BOOK

Date	Name	Particulars	Led. Fol.	Total	Dept. 1	Dept. 2	Dept. 3	Dept. 4

DEPARTMENTAL PURCHASES BOOK

Date	Name	Particulars	Led. Fol.	Total	Provisions	Grocery	Fish	Fruit

Dr. **WAGES ACCOUNT** *Cr.*

19..		Fol.	Tota	Dept. A	Dept. B	Dept. C	19..		Fol.	Total	Dept. A	Dept. B	Dept. C

1. The individual turnover or output;
2. The floor space occupied by each department; or
3. The wage cost of each department.

Whichever method is adopted, it will be necessary, at the end of the financial year, to compile a list of the indirect expenses and charges and to allocate them to the various units. From the information then available it is possible to compile a Departmental Profit and Loss Account which will give the net profit (or loss) made by each department. The balances of this account are transferred to a General Profit and Loss Account which will include sundry items of office and management expenditure such as directors' fees, income tax, bank charges, interest, etc.

Inter-departmental transactions are dealt with either by opening separate accounts for these or by treating these dealings as ordinary purchases and sales. The former method is to be preferred, as this obviates the necessity of providing for departmental profit, which is likely to arise unless the goods transferred are accurately priced. If dealt with separately, transfers will be debited to the Trading Account of the receiving department and credited to the Trading Account of the issuing department.

The example below clearly shows the manner in which the Departmental Trading and Profit and Loss Accounts are compiled, and the incorporation of the sectional balances in the final accounts of the business.

EXAMPLE 1. The Trial Balance, given on page 188 is that of the Parkstone Trading Co., Ltd., as at 31st December, 19...

Indirect items must be apportioned on the basis of turnover.

Before preparing a Departmental Trading and Profit and Loss Account, a General Profit and Loss and Appropriation Account and a Balance Sheet, the following adjustments must be made—

Depreciate: Plant and machinery 10 per cent.
Buildings 5 per cent.

Reserve 5 per cent on Debtors for bad debts.

Directors' Fees due amount to £2,500.

Transfer £3,500 to Reserve.

Provide for a dividend of 12 per cent on the Company's paid-up capital.

Value of stock at 31st December was: Dept. A £9,500, and Dept. B £6,890.

	£	£
Nominal and Issued Capital— 20,000 shares of £1 each		20,000
Reserve		3,000
Purchases (Dept. A)	25,500	
,, (Dept. B)	18,700	
Sales (Dept. A)		40,610
,, (Dept. B)		35,500
Returns (Dept. A)	610	250
,, (Dept. B)	500	600
Wages (Dept. A)	4,400	
,, (Dept. B)	3,350	
Stock (Dept. A)	8,640	
,, (Dept. B)	5,750	
Insurance	210	
Trade Expenses (Dept. A)	200	
,, ,, (Dept. B)	200	
Salaries	1,500	
Bad Debts	300	
Plant and Machinery	10,600	
Buildings	8,500	
Debtors	4,960	
Creditors		1,180
Rates and Taxes	360	
Cash at Bank	6,800	
Cash in Hand	60	
	£101,140	£101,140

The solution to this example will be found on pages 189–91.

The method of dissecting or analysing the various items set out above should not be confused with "Tabular" book-keeping. The latter is a system by which the items are subjected to continuous analysis, and it is usually confined to the Ledger only. The trouble of periodically summarizing transactions is, therefore, avoided. The "tabular" method is generally adopted to record transactions of a recurring nature, viz. the daily or weekly transactions in the Hotel Visitors' Ledger.

THE PARKSTONE TRADING CO., LTD.

DEPARTMENTAL TRADING AND PROFIT AND LOSS ACCOUNT

Dr. FOR THE YEAR ENDED 31ST DECEMBER, 19.. *Cr.*

	Dept. A	Dept. B	Total		Dept. A	Dept. B	Total
	£	£	£		£	£	£
To Stock, 1st January	8,640	5,750	14,390	By Sales (*less* Returns)	40,000	35,000	75,000
,, Purchases (*less* Returns)	25,250	18,100	43,350	,, Stock, 31st December	9,500	6,890	16,390
,, Wages	4,400	3,350	7,750				
,, Gross Profit c/d	11,210	14,690	25,900				
	£49,500	41,890	91,390		£49,500	41,890	91,390
To Trade Expenses	200	200	400	By Gross Profit b/d	11,210	14,690	25,900
,, Insurance	112	98	210				
,, Salaries	800	700	1,500				
,, Bad Debts	160	140	300				
,, Rates and Taxes	192	168	360				
,, Net Profit c/d	9,746	13,384	23,130				
	£11,210	14,690	25,900		£11,210	14,690	25,900

GENERAL PROFIT AND LOSS ACCOUNT

Dr. FOR THE YEAR ENDED 31ST DECEMBER, 19.. *Cr.*

	£	£		£	£
To Depreciation—			By Net Profit from Departmental Accounts—		
Plant and Machinery	1,060		Dept. A	9,746	
Buildings	425		Dept. B	13,384	
		1,485			23,130
,, Bad Debts Reserve		248			
,, Directors' Fees		2,500			
,, Balance c/d		18,897			
		£23,130			£23,130
To Dividend of 12 per cent on £20,000		2,400	By Balance b/d		18,897
,, Transfer to Reserve		3,500			
,, Balance carried forward		12,997			
		£18,897			£18,897

THE PARKSTONE TRADING CO., LTD.

BALANCE SHEET

AS AT 31ST DECEMBER, 19..

Liabilities	£	*Assets*	£
Nominal Capital—		Buildings (*less* Depreciation)	8,075
20,000 £1 Shares	20,000	Plant and Machinery (*less* Depreciation)	9,540
		Stock	16,390
Issued Capital—		Debtors (*less* Bad Debts Reserve)	4,712
20,000 £1 Shares, fully paid	20,000	Cash in Hand	60
Reserve	6,500	Cash at Bank	6,800
Creditors	1,180		
Directors' Fees	2,500		
Dividend	2,400		
Profit and Loss Account	12,997		
	£45,577		£45,577

EXERCISE VII

A. State briefly the benefits to be derived from a system of departmental accounts.

B. Where the "Net" profit of each department is required, in what way is the book-keeping more complicated?

C. James Ravary divides his business into four departments, viz., Motors, Petrol, Cycles, and Repairs. He desires to ascertain the results obtained by each department. How should the wages and purchases be treated in order to achieve the result desired? Submit a ruling of any book, or books, you would recommend Ravary to keep to achieve this purpose. (R.S.A.)

D. Blanks, Ltd., own a large retail stores consisting of many departments. A considerable number of inter-departmental transfers of both goods and services take place. You are required to state the basis upon which these inter-departmental transfers should be recorded in the books of the company. (R.S.A.)

E. Dicksons, Ltd., divide their business into four departments. You find that, in the Departmental Profit and Loss Accounts, all items capable of direct departmental debit or credit have been correctly treated. You also find that rent and rates, income tax, lighting and heating, travellers' salaries and commission, insurance, office expenses and directors' fees have been debited to the various departments in proportion to the sales. If, in your opinion, this method may be inequitable with regard to all, or any, of the above charges, state the basis upon which you would advise the allocations to be made. (R.S.A.)

F. What do you understand by the term "Tabular Book-keeping"? To which type of business can this method of book-keeping be applied with advantage?

G. A business is composed of four departments, A, B, C, and D. At the close of the financial year the results were—

Departments	A	B	C	D
	£	£	£	£
Stock (opening)	6,500	3,000	8,000	2,500
Purchases	14,000	19,000	26,000	12,000
Sales	16,000	24,000	30,000	10,000
Stock (closing)	8,500	2,000	7,000	9,000

The following expenses, which are to be charged in proportion to the turnover of each department, were also disclosed by the accounts—

	£
Salaries	3,000
Rent	1,800
General Expenses	320
Insurance	400
Carriage	1,000

Give the final results of each department.

H. From the following Trial Balance of a limited company whose business is composed of two departments, Works and Retail, compile Departmental Trading and Profit and Loss Accounts, a General Profit and Loss Account, and a Balance Sheet.

	£		£
Capital, 70,000 £1 shares	70,000	*Retail* Department—	
Debtors . . .	12,105	Purchases (*less* returns)	48,700
Creditors . . .	10,055	Sales (*less* returns) .	76,453
Office Furniture . .	750	Wages . . .	10,810
Premises . . .	16,000	Trade Expenses . .	2,300
Investments . . .	10,000	Insurance . . .	600
Salaries . . .	3,600	Stock (opening) . .	15,865
General Expenses . .	1,976	Discount (Dr.) . .	215
Bad Debts . . .	415		
Interest (Cr.) . .	250		
Directors' Fees . .	2,500		
Legal Charges . .	115		
Plant	30,000		
Cash in Hand . .	105		
Cash at Bank . .	9,895		
Works Department—			
Purchases (*less* returns)	32,690		
Sales (*less* returns) .	60,312		
Wages . . .	6,410		
Trade Expenses . .	1,035		
Insurance . . .	250		
Stock (opening) . .	10,749		
Discount (Cr.) . .	15		

When drawing up the General Profit and Loss Account the following matters must be taken into consideration—

(*a*) Closing Stocks valued at: Works, £11,352; Retail, £13,441.

(*b*) Depreciate Office Furniture, 10 per cent; Plant, £4,000, and Premises, 5 per cent.

(*c*) Create a reserve of £500 for Bad Debts.

(*d*) Directors' Fees due amount to £1,000. No entries have been passed through the books.

X **I.** The following is the Trial Balance of the A and B Trading Co., Ltd., which has two departments, A and B.

	£	£
Capital, 120,000 £1 shares		120,000
Calls in Arrear	100	
Cash at Bank	34,500	
Cash in Hand	50	
Debtors	42,000	
Debentures		15,000
Interest on Debentures	600	
Stock (opening), Dept. A	16,000	
,, ,, Dept. B	20,000	
Purchases, Dept. A	32,000	
,, Dept. B	25,000	
Sales, Dept. A		82,000
,, Dept. B		51,000
Wages, Dept. A	18,230	
,, Dept. B	14,210	
Rent, Rates, and Taxes	1,500	
Insurance	600	
Wages and Salaries (Indirect)	8,000	
Printing and Stationery	250	
Advertising	1,200	
General Trade Expenses	6,500	
Bad Debts	260	
Plant and Machinery	30,000	
Buildings	15,000	
Creditors		8,000
Investments	10,000	

When preparing the accounts the undermentioned adjustments should be made—

(*a*) A valuation of the closing stock was: Dept. A, £15,000; Dept. B, £18,000.

(*b*) Depreciate Buildings 2½ per cent, and Plant 5 per cent.

(*c*) Wages (£500) charged to Dept. A were expended on factory improvements. When depreciating the Buildings, this amount should not be taken into consideration, the depreciation being based on the original figure.

From the foregoing list of balances and particulars, prepare Departmental Trading Account, General Profit and Loss Account, and Balance Sheet.

J. From the following Trial Balance of the Cotton, Woollen, and Silk Buyers' Association, Ltd., prepare the Departmental Trading Accounts, Profit and Loss Account, and a Balance Sheet as at 31st December, 19..

	£	£
Stock—Woollen Dept.	1,500	
,, Cotton Dept.	1,200	
,, Silk Dept.	2,000	
Purchases—Woollen Dept.	10,600	
,, Cotton Dept.	7,200	
,, Silk Dept.	14,000	
Sales—Woollen Dept.		16,150
,, Cotton Dept.		14,000
,, Silk Dept.		24,120
Wages—Woollen Dept.	1,720	
,, Cotton Dept.	869	
,, Silk Dept.	1,220	
Carriage Inwards—Woollen Dept.	461	
,, ,, Cotton Dept.	240	
,, ,, Silk Dept.	470	
Direct Charges—Woollen Dept.	1,720	
,, ,, Cotton Dept.	1,500	
,, ,, Silk Dept.	1,890	
Salaries	1,000	
Advertising	620	
Bad Debts	90	
Bank Interest and Charges	25	
Buildings	3,500	
Plant and Machinery	12,000	
Patent Rights	1,500	
Indirect Expenses	1,690	
Travellers' Expenses	1,500	
Discount	500	
Insurance	260	
Creditors		5,900
Debtors	610	
Cash at Bank	1,245	
Cash in Hand	20	
Share Capital		10,980

The closing Stocks were: Woollen Department, £2,000; Cotton Department, £1,900; Silk Department, £4,000. Write off the following depreciations—

(*a*) Buildings, 5 per cent.
(*b*) Plant and Machinery, 7½ per cent.
(*c*) Reduce Patents Rights to £1,200.

CHAPTER VIII

BRANCH ACCOUNTS

THE accounts of a business having one or more branches will be conducted on somewhat similar lines to those set out in the previous chapter. Each branch is considered an independent unit, and the method of recording the trading transactions will depend on the relationship which exists between the branch and its head office. Branch accounts may be divided into three main classes—

1. Those in which the branch transactions are recorded in books kept at the head office, by means of periodical returns or statements rendered by the local official.
2. Those in which each branch keeps its own books.
3. Foreign or colonial branches.

A further division may be made between branches conducting wholesale and those conducting retail business, but this classification has very little effect on the manner in which the accounts are prepared. Where goods are priced to the branches above cost price, it is usual to keep the branch accounts in the head office books in columnar form, so that details of the cost and retail prices of the goods supplied can therein be recorded. Each system will be found in practice to possess its own advantages, and the type of business carried on will be the determining factor when deciding which system should be adopted.

Transactions Recorded at Head Office.

Entry is made in the head office books by means of periodical returns. When the goods sold by the branch are supplied by the head office, it will be necessary either to keep separate Day Books for each branch or to use one book ruled with analysis columns. An account for each branch is opened in the General Ledger, to which is debited the value of the goods

forwarded, the credit entry appearing in a "Goods to Branch Account." Where, however, the branch purchases its own goods, a copy of the invoice, certified by the branch manager, is forwarded to head office, and entry is thereupon made in the Branch Account. The total of the goods supplied to branches is eventually credited to the head office Trading Account, but where the goods are bought locally, the total is debited to the Branch Trading Account.

A return of the sales of each branch will be made either daily or weekly, and the amount representing the takings will be deposited at a local bank or forwarded direct to the head office. The Cash Book at head office will contain a number of analysis columns so that when remittances are received, these can be credited at once to the branches concerned, and, as a result, the rather formidable task of analysing all these remittance entries at the end of the financial year is avoided. If the takings are banked, entry will be made in the head office books upon receipt of relevant information from the branch manager, or when confirmation of the deposit is received from the bankers.

Details of wages and other expenses will also be rendered to the head office at regular periods. The total of this expenditure will be debited to the Branch Account or to special Expenses Accounts opened for each branch, the balance of which is subsequently transferred to the Branch Profit and Loss Account. Either of two methods may be adopted regarding the supply of cash from which these expenses may be paid. The manager may be supplied with the necessary cash from head office, or payment may be made from the takings of the branch, in which case only the net amount or balance is banked or remitted to head office. The first method will be found to be the more widely used, the head office Cash Book being credited and the Branch (or Branch Expenses) Account debited with the expenses paid.

From the foregoing remarks it will be seen that the statistical returns which are submitted by the branch contain particulars of—

1. The value of purchases made locally.

2. The amount of sales and particulars of local deposits where the takings are banked.

3. The wages, commission, and other expenses.

In cases where the sales of the branch include credit sales, particulars will also be forwarded as to the amounts outstanding at the date of the return, together with details of the accounts settled by debtors since the date of the last return.

At the close of the trading year, the totals of the Branch Account in the Ledger will be transferred to the Trading and Profit and Loss Account which will be prepared in the same way as that for a business composed of several departments. In some businesses the whole of the transactions are shown under one account—the Branch Account—and the balance of this only, which represents gross profit, is transferred to the head office Trading and Profit and Loss Account (see Example 1 below). Where, however, separate accounts are kept for Expenses, Debtors, Remittances, etc., of each branch, the totals of these may either be transferred to a Branch Profit and Loss Account or posted to a General Profit and Loss Account having columns on each side for every branch. If the number of branches is large, the first method is adopted, only the gross profit (or loss) for each branch being transferred to the Head Office Account.

In some cases, it is the practice to prepare monthly statements or summaries which give the totals of sales and expenses. From these summaries two chief benefits arise ; (*a*) where returns are made up regularly the risk of errors is diminished, and (*b*) comparative returns always reveal valuable information.

EXAMPLE 1. The following particulars appear in the head office books and relate to a branch conducting purely a cash business. Prepare a Branch Account showing the gross profit.

	£	s.	d.
Goods supplied from Head Office	3,640	10	1
Returns to Head Office	15	7	4
Rates and Insurance	23	14	9
Wages and Salaries	315	15	–
Stock (opening)	1,060	12	6
General Expenses	5	10	5
Stock (closing)	1,211	18	1
Remittances to Head Office	4,791	15	11

Dr. BRANCH ACCOUNT *Cr.*

	£	s.	d.		£	s.	d.
To Balance	1,060	12	6	By Cash Remitted	4,791	15	11
,, Goods supplied	3,640	10	1	,, Returns to Head Office	15	7	4
,, Expenses—				,, Balance (Stock) c/d	1,211	18	1
Rates and Insurance	23	14	9				
Wages and Salaries	315	15	–				
General	5	10	5				
,, Balance (profit)	972	18	7				
	£6,019	1	4		£6,019	1	4
To Balance b/d	1,211	18	1				

EXAMPLE 2. The following particulars relate to a branch conducting both cash and credit sales. Prepare a separate Branch Account for Goods Supplied, Expenses and Debtors, and show the final result by means of a Branch Profit and Loss Account.

	£	s.	d.
Goods supplied from Head Office	7,431	8	4
Returns to Head Office	84	2	6
Returns from Customers	114	10	1
Sales, Cash	5,041	6	5
Sales, Credit	3,852	7	2
Discounts	40	8	2
Rent and Rates	150	–	–
Wages	810	10	–
Stock (opening)	750	16	11
Stock (closing)	1,812	2	3
Debtors (opening)	1,260	3	9
Debtors (closing)	1,078	11	1
Cash received from Debtors	3,889	1	7

Dr. BRANCH (GOODS) ACCOUNT *Cr.*

	£	s.	d.		£	s.	d.
To Balance	750	16	11	By Cash Sales	5,041	6	5
,, Goods supplied	7,431	8	4	,, Credit Sales	3,852	7	2
,, Returns (Customers)	114	10	1	,, Returns (Head Office)	84	2	6
,, Balance (to Branch Profit and Loss A/c)	2,493	3	–	,, Stock c/d	1,812	2	3
£	10,789	18	4	£	10,789	18	4
To Balance b/d	1,812	2	3				

Dr. BRANCH (DEBTORS) ACCOUNT *Cr.*

	£	s.	d.		£	s.	d.
To Balance . .	1,260	3	9	By Cash . .	3,889	1	7
,, Sales (credit) .	3,852	7	2	,, Discount . .	40	8	2
				,, Returns . .	114	10	1
				,, Balance c/d .	1,068	11	1
	£5,112	10	11		£5,112	10	11
To Balance b/d .	1,068	11	1				

Dr. BRANCH (EXPENSES) ACCOUNT *Cr.*

	£	s.	d.		£	s.	d.
To Discounts .	40	8	2	By Branch Profit and Loss A/c .	1,000	18	2
,, Rent and Rates	150	–	–				
,, Wages . .	810	10	–				
	£1,000	18	2		£1,000	18	2

Dr. BRANCH PROFIT AND LOSS ACCOUNT *Cr.*

	£	s.	d.		£	s.	d.
To Branch (Exp's.) Account .	1,000	18	2	By Branch (Goods) Account .	2,493	3	–
,, Head Office Profit and Loss Account .	1,492	4	10				
	£2,493	3	–		£2,493	3	–

It is not unusual for some firms to charge out goods to the branches at a percentage on cost, the Branch Supplies (or Goods to Branches) Book being ruled with an extra column in which the invoice price can be inserted. When the branch accounts in the head office books are being prepared, it will be necessary to reduce the purchases (or goods supplied to branches), and the opening and closing stocks to *cost* price so that the profit can be accurately calculated. In arriving at the cost price, the student is apt to make a rather common error. Assuming goods to the value of £500 have been sent to a branch invoiced at 25 per cent on cost, the value of the goods appearing in the branch books will be £625. In reducing this figure to the cost price, it must not be thought that by dividing £625 by 4 the cost price will be ascertained. On every £125 worth of goods sent, £25 has been added, so that

the increase is $\frac{25}{125}$ or one-fifth. It is, therefore, necessary to divide by five and not by four.

EXAMPLE 3. From the figures given below write up the branch account in the head office books. Only cash dealings are transacted by the branch, to which goods are invoiced at 20 per cent on cost.

	£
Goods to Branch (*less* Returns)	10,770
Wages paid	863
Cash Remitted to Head Office	10,621
Rent and Rates paid	265
Stock (opening)	1,740
Stock (closing)	2,208
General Expenses paid	63

Dr. BRANCH ACCOUNT *Cr.*

		£			£
	To Stock b/d . .	1,450		By Cash Remitted .	10,621
	,, Goods . . .	8,975		,, Stock . . .	1,840
	,, Wages . . .	863			
	,, Rent and Rates .	265			
	,, General Expenses .	63			
	,, Profit . . .	845			
		£12,461			£12,461

Independent Trading Branches.

Branches that trade independently of head office usually keep their own books, forwarding from time to time statistical returns, and finally, a Trial Balance, particulars of which are incorporated in the head office accounts.

The branch and its head office stand almost in the relation of debtor and creditor, the transactions of each as far as they concern each other being recorded by means of a "Head Office Account" in the branch books and a "Branch Account" in the head office books. The Head Office Account in the books of the branch approximates to the capital account of a sole trader, the excess over liabilities representing the liability of the branch to the head office. At regular intervals the branch will send remittances to head office or deposit the cash takings at a local bank. Where the former method is adopted, and the remittances are numerous, it may be found advisable to keep a special Remittances Account in

the head office books apart from the Cash (or Cash Received) Book, ruled with a number of columns, from which transfers may be made to the Branch Accounts concerned. In the branch books a corresponding account will be styled "Remittances to Head Office," the totals thereof being periodically posted to the Head Office Account.

When the financial year comes to an end, a list of the balances of its accounts is compiled by each branch from which the Trading and Profit and Loss Account can be prepared. Unless certain adjustments are made, it is unlikely that complete agreement between the head office and branch books will be reached. This disagreement will most likely arise where goods and/or remittances are in course of transit when the list of balances is prepared, and reconciliation between the two sets of books is made by means of special accounts for "goods in transit" and "remittances in transit." Journal entries will be made in the head office books to effect the adjustment, but the student should carefully note that these transit items will not appear in the Balance Sheet.

EXAMPLE 4. From the following Trial Balance of the Sheldon Branch of the Maingood Trading Co., Ltd., as at 31st December, 19.., write up the accounts in the branch and head office books, and draw up the final accounts for the branch.

	£	s.	d.	£	s.	d.
Sundry Debtors	1,476	10	2			
Goods from Head Office	2,318	7	5			
Stock, 1st January	369	14	4			
Sundry Creditors				1,022	13	11
Purchases	2,000	–	–			
Sales				6,169	12	6
Wages	862	11	3			
Salaries	250	–	–			
Bad Debts	14	17	4			
Rent and Rates	110	10	–			
Discount (balance)				17	5	6
Head Office Account, 1st January				1,893	5	9
Cash	190	7	2			
Remittances to Head Office	1,200	–	–			
Fixtures	310	–	–			

Stock, 31st December, £510 18s. 6d.

Head Office Books.

Dr. BRANCH REMITTANCES ACCOUNT *Cr.*

		£ s. d.			£ s. d.
	To Branch Account	1,200 – –		By Cash . .	1,200 – –

Dr. BRANCH ACCOUNT *Cr.*

		£ s. d.			£ s. d.
	To Balance . .	1,893 5 9		By Remittance A/c	1,200 – –
	,, Sales . .	6,169 12 6		,, Stock, 1st Jan.	369 14 4
	,, Discount . .	17 5 6		,, Goods supplied	2,318 7 5
	,, Stock, 31st Dec.	510 18 6		,, Purchases .	2,000 – –
				,, Wages . .	862 11 3
				,, Salaries . .	250 – –
				,, Rent and Rates	110 10 –
				,, Bad Debts .	14 17 4
				,, Balance c/d .	1,465 1 11
		£8,591 2 3			£8,591 2 3
	To Balance b/d .	1,465 1 11			

Branch Books.

Dr. REMITTANCES TO HEAD OFFICE ACCOUNT *Cr.*

		£ s. d.			£ s. d.
	To Cash . .	1,200 – –		By Head Office A/c	1,200 – –

Dr. HEAD OFFICE ACCOUNT *Cr.*

		£ s. d.			£ s. d.
	To Remittance A/c	1,200 – –		By Balance . .	1,893 5 9
	,, Balance c/d .	1,465 1 11		,, Net Profit .	771 16 2
		£2,665 1 11			£2,665 1 11
				By Balance b/d .	1,465 1 11

TRADING AND PROFIT AND LOSS ACCOUNT
OF THE SHELDON BRANCH

Dr. FOR THE YEAR ENDED 31ST DECEMBER, 19.. *Cr.*

	£	s.	d.		£	s.	d.
To Stock, 1st Jan.	369	14	4	By Sales . . .	6,169	12	6
,, Goods from H.O.	2,318	7	5	,, Stock, 31st Dec.	510	18	6
,, Purchases .	2,000	-	–				
,, Gross Profit c/d	1,992	9	3				
	£6,680	11	–		£6,680	11	–
To Wages . .	862	11	3	By Gross Profit b/d	1,992	9	3
,, Salaries . .	250	–	–	,, Discount . .	17	5	6
,, Rent and Rates	110	10	-				
,, Bad Debts .	14	17	4				
,, Net Profit(transferred to H.O. Account) .	771	16	2				
	£2,009	14	9		£2,009	14	9

BALANCE SHEET
AS AT 31ST DECEMBER, 19..

Liabilities	£	s.	d.	*Assets*	£	s.	d.
Creditors . .	1,022	13	11	Cash . . .	190	7	2
Head Office A/c .	1,465	1	11	Debtors . .	1,476	10	2
				Stock . . .	510	18	6
				Fixtures . .	310	-	–
	£2,487	15	10		£2,487	15	10

EXAMPLE 5. The Trial Balances set out on page 206 have been taken from the books of the head office and branches of the Merchant Trading Co., Ltd., at 30th June, 19... Prepare Branch Trading and Profit and Loss Accounts, a General Trading and Profit and Loss Account and a Balance Sheet for the year ended 30th June, 19... When preparing these

accounts, the following adjustments must be taken into consideration—

	North Branch	South Branch	Head Office
	£	£	£
(a) Closing Stock .	5,021	3,889	20,212
(b) Create Bad Debts Reserve . .	250	200	
(c) Depreciate—			
Fixtures .	70	65	5%
Premises .			2½%
Plant . .			10%

BRANCH TRADING AND PROFIT AND LOSS ACCOUNTS

Dr. FOR THE YEAR ENDED 30TH JUNE, 19.. *Cr.*

	North	South		North	South
	£	£		£	£
To Stock, 1st July .	4,172	3,685	By Sales . . .	62,677	54,417
,, Goods from H.O. .	48,916	41,702	,, Stock, 30th June .	5,021	3,889
,, Wages . . .	2,370	1,642			
,, Gross Profit c/d .	12,240	11,277			
	£67,698	£58,306		£67,698	£58,306

	£	£		£	£
To Rates and Taxes .	417	382	By Gross Profit b/d .	12,240	11,277
,, General Expenses .	1,390	1,264			
,, Carriage . . .	1,014	876			
,, Bad Debts . .	116	874			
,, Depreciation— Fixtures . .	70	65			
,, Bad Debts Reserve .	250	200			
,, Net Profit (transferred to H.O. P. & L. A/c) . . .	8,983	7,616			
	£12,240	£11,277		£12,240	£11,277

TRIAL BALANCES. MERCHANT TRADING CO., LTD.

30TH JUNE, 19. .

	Dr.			Cr.		
	Branches		Head Office	Branches		Head Office
	North	South		North	South	
	£	£	£	£	£	£
Purchases			43,215			
Stock, 1st July	4,172	3,685	22,918			
Wages	2,370	1,642	17,721			
Salaries			6,740			
General Expenses	1,390	1,264	1,015			
Goods supplied to Branches	48,916	41,702				90,618
Bad Debts	116	874				
Sales				62,677	54,417	
Rates and Taxes	417	382	1,126			
Insurance			2,145			
Premises			15,000			
Goodwill			10,000			
Plant			25,000			
Fixtures	1,400	1,360	1,500			
Cash in Hand	36	32	210			
Cash at Bank			6,810			
Income Tax			275			
Directors' Fees			2,000			
Branch Accounts—						
North			1,742			
South			1,708			
Head Office Account	4,868	5,923		1,742	1,708	
Debtors						
Creditors				280	1,615	6,068
Carriage	1,014	876	2,561			
Capital— 65,000 £1 shares						65,000
	£64,699	£57,740	£161,686	£64,699	£57,740	£161,686

TRADING AND PROFIT AND LOSS ACCOUNT
OF THE MERCHANT TRADING CO., LTD.

Dr. FOR THE YEAR ENDED 30TH JUNE, 19.. *Cr.*

	£		£
To Stock, 1st July	22,918	By Goods to Branches	90,618
,, Purchases	43,215	,, Stock, 30th June	20,212
,, Wages	17,721		
,, Carriage	2,561		
,, Gross Profit c/d	24,415		
	£110,830		£110,830
To Salaries	6,740	By Gross Profit b/d	24,415
,, General Expenses	1,015		
,, Rates and Taxes	1,126		
,, Insurance	2,145		
,, Income Tax	275		
,, Directors' Fees	2,000		
,, Depreciation—			
Fixtures	75		
Premises	375		
Plant	2,500		
,, Net Profit c/d	8,164		
	£24,415		£24,415
To Balance carried forward	24,763	By Net Profit b/d	8,164
		,, Net Profit, North Branch	8,983
		,, Net Profit, South Branch	7,616
	£24,763		£24,763

The Balance Sheet appears on page 208.

In the foregoing example it will be observed that depreciation of branch assets is adjusted at head office when the complete final accounts are prepared. This course is usually adopted where only the Trial Balance is received from the branch, but when each branch compiles its own final accounts (as in the case of foreign branches), it is customary to make provision locally for the depreciation and wear and tear.

Inter-Branch Dealings.

Where branches are permitted to trade directly with each

MERCHANT TRADING CO., LTD.
BALANCE SHEET, AS AT 30TH JUNE, 19..

Liabilities	£	£
Nominal Capital—		
65,000 £1 shares		65,000
Issued Capital—		
65,000 £1 shares, fully paid		65,000
Creditors—		
Head Office	6,068	
North Branch	280	
South Branch	1,615	
		7,963
Profit and Loss Account—		
Balance carried forward		24,763
		£97 726

Assets		£	£
Goodwill			10,000
Premises		15,000	
Less Depreciation		375	
			14,625
Plant		25,000	
Less Depreciation		2,500	
			22,500
Fixtures—			
Head Office	£1,500		
Less Depreciation	75		
		1,425	
North Branch	£1,400		
Less Depreciation	70		
		1,330	
South Branch	£1,360		
Less Depreciation	65		
		1,295	
			4,050
Stocks—			
Head Office		20,212	
North Branch		5,021	
South Branch		3,889	
			29,122
Debtors—			
North Branch	£4,868		
Less Reserve	250		
		4,618	
South Branch	£5,923		
Less Reserve	200		
		5,723	
			10,341
Cash and Bank—			
Head Office		7,020	
North Branch		36	
South Branch		32	
			7,088
			£97,726

other, it will be necessary for each branch to keep a Current Account in addition to the Head Office Account. Sales made to a branch are debited to the ". . . Branch Current Account" and credited to an Inter-Branch Sales Account. Conversely, the value of goods purchased from a branch are debited to an Inter-Branch Purchases Account and credited to the Current Account of the branch from which the goods are bought. The balances of these Current Accounts will appear in the returns made by the branch managers to head office, where they will be recorded in a separate book kept for inter-branch transactions.

Interim Stock Records.

With a view to maintaining a check on local branch officials, it is not unusual for large firms, controlling a number of shops or branches, to compile a periodical statistical record of the estimated stock-on-hand at each branch or shop.

The average gross profit on the sales of each branch is fixed at a standard rate. The total goods supplied (or purchased) will be ascertained from the head office books, where the goods are supplied from head office, and from the branch statistical returns, where the branch makes local purchases. The sales, of course, will be included in the returns made by the manager to head office. Before the Interim Accounts can be prepared, reconciliation of the opening stock, the purchases, and the sales is necessary, because whereas the two former items appear in the head office books at *cost* price, the sales are returned at *selling* price. Thus, the necessity for a profit-fixing standard is obvious. The sales are reduced to *cost* price by deducting the standard rate of profit, and when this has been done, the resultant calculation is deducted from the total of the opening stock and purchases, the balance being the estimated stock-on-hand at cost price.

EXAMPLE 6. A concern consists of three departments, X, Y, and Z. The standard rate of profit is fixed at 25 per cent, 20 per cent, and 12½ per cent respectively. From the following particulars compile an Interim Stock Account for the fortnight ending 21st March, 19...

	Departments X	Departments Y	Departments Z
	£	£	£
Stock, 7th March	2,250	1,970	3,021
Purchases, 21st March	8,742	6,980	9,375
Sales, 21st March	12,604	10,835	11,232

INTERIM STOCK ACCOUNT

FOR THE FORTNIGHT ENDING 21ST MARCH, 19..

	Dept. X		Dept. Y		Dept. Z	
	Average rate of profit, 25% on Selling Price		Average rate of profit, 20% on Selling Price		Average rate of profit, 12½% on Selling Price	
	£	£	£	£	£	£
Starting Stock (cost price)		2,250		1,970		3,021
Purchases (cost price)		8,742		6,980		9,375
		10,992		8,950		12,396
Sales (selling price)	12,604		10,835		11,232	
Less Estimated Profit	3,151		2,167		1,404	
		9,453		8,668		9,828
Estimated Stock (cost price)	—	£1,539	—	£282	—	£2,568

Although accompanied by certain advantages, the preparation of Interim Stock Accounts has its limitations, for it can be applied only where—

1. The margin of profit is subject to but little variation.
2. Stock is taken at regular intervals.
3. Leakage and loss can be accurately ascertained.

Apart from the value of the comparative statistics given by such a method, and the fact that violent fluctuations in the stocks held by each branch are instantly revealed, these Stock Accounts also assist the proprietors of a business in that they fairly accurately disclose at almost any time whether or not the stock held is adequately covered by insurance. It must not, however, be thought that the compilation of these accounts dispenses altogether with the necessity to take stock in the proper and orthodox manner; the main object of the

Interim Stock Account is to maintain a check on branch managers and others in charge of stock, although the results shown by these accounts may be judiciously compared with those revealed by accurate stocktaking.

Foreign Branches.

The accounts of businesses having branches situated in foreign countries and the dominions are subject to the same principles and are dealt with in the same way as of those possessing only home branches. The chief exception, however, is that the accounts are rendered somewhat more complicated by reason of the fact that the branch abroad will naturally record its dealings in the currency of the country in which it trades and, accordingly, the periodical returns to the chief office will also be expressed in foreign currency.

The Head Office books which deal with foreign branch transactions will, therefore, have to be so ruled as to give particulars of the sterling and foreign currency of each remittance, and the exchange rate at which it is converted. To do this, the Remittance Account will have two extra columns on each side (see example on next page). This alteration does not, however, dispense with the fluctuations which may arise in the rates of exchange at which the conversions from foreign currency to sterling are made.

The conversion of foreign currency into sterling (or *vice versa*) will, of course, involve the exercise of certain arithmetical rules with which the student of Advanced Bookkeeping will already be conversant.

Stable Exchange Rates.

In the case of countries where the rate of exchange is more or less stable, it is possible to adopt a stable rate for the conversion of all items of currency. This rate will approximate closely to the normal or par rate of exchange existing between the country in which the branch is situate and Britain. The risk of over- or under-valuation is, therefore, considerably reduced.

REMITTANCES FROM LYONS BRANCH

Dr | *Cr.*

Date		Fol.	Francs	Rate of Exch.	£ s. d.	Date		Fol.	Francs	Rate of Exch.	£ s. d.
19.. Dec. 31	To Branch Account		78,600	$96\frac{1}{4}$	816 14 7	19.. July 15	By Cash		14,590	$95\frac{1}{8}$	153 7 7
						Aug. 16	,, ,,		10,275	$97\frac{3}{8}$	105 10 5
						Sept. 10	,, ,,		15,742	$96\frac{1}{8}$	162 10 –
						Nov. 1	,, ,,		10,681	$94\frac{1}{8}$	113 9 6
	,, Profit or Loss on Exchange Account					25	,, ,,		17,462	$94\frac{3}{8}$	185 – 7
					5 2 4	Dec. 30	,, ,,		9,850	$96\frac{3}{8}$	101 18 10
			78,600		£821 16 11				78,600		£821 16 11

PROFIT OR LOSS ON EXCHANGE ACCOUNT

Dr. | *Cr.*

Date		£ s. d.	Date		£ s. d.
19..			19.. Dec. 31	By Lyons Branch Remittance Account	5 2 4

In addition to the Remittance Account, it will also be necessary to rule the Branch Account suitably in the Head Office books to permit each item, apart from remittances, being recorded in both sterling and foreign currency. Any difference between the two columns will be debited (or credited, according to the nature of the difference) to a "Profit or Loss on Exchange Account." At the close of the financial year, the balance of this account is transferred to profit and loss. A specimen Branch Account is given below.

Dr. LUGANO BRANCH ACCOUNT *Cr.*

19..		Fol.	Francs	Sterling	19..		Fol.	Francs	Sterling
				£ *s. d.*					£ *s. d.*

Fluctuating Exchange Rates.

Post-War upheaval has had a considerable effect on world exchange rates, with the result that the fixing of standard conversion rates for the majority of currencies would be little short of disastrous. The values arrived at as the outcome of fixed conversions would probably differ greatly from the actual rates subsequently realized in view of the frequent changes which would have an important bearing on the ultimate trading results of the branch. To overcome this difficulty, and, in order to arrive as near as possible to the true profit or loss, it is advisable to adopt the following or some similar basis. Convert—

1. Remittances from branches at the actual rate ruling on the day they are sent or cashed.

2. Fixed assets and additions thereto at the rate ruling at the time they were acquired. (It is sometimes provided in

the case of additions, that an average rate for the year or period be taken.)

3. Floating assets and liabilities at the current rate ruling at the time the books are balanced.

4. Nominal accounts (or items affecting the Trading and Profit and Loss Account) at an average rate for the period covered by the accounts.

The Trial Balance submitted by the branch will be converted into sterling before the items included therein are incorporated in the Head Office books. It will be found that the columns of this balance rarely agree after conversion has been made, and, in order that they shall correspond, the difference should be posted to a "Difference in Exchange Account." (This is the same as the "Profit or Loss on Exchange Account" previously mentioned—the same account may be used to record differences arising on the conversion of both the Branch Account and the Trial Balance.) The balance of this account will be transferred to the Profit and Loss Account.

Instead of sending the Trial Balance, it is sometimes customary to arrange that the foreign branch shall forward to the Head Office a certified copy of its own Trading and Profit and Loss Account and Balance Sheet. It will then be necessary to enter only the net profit (or loss) in the head office books, which is done by means of the following Journal entry—

			£	£
	................Branch Current Account *Dr.*		——	
	To Profit and Loss Account . .			——
	Being transfer of profit for .... Branch.			

If there has been a loss on trading, a reverse entry would be made. The items in the branch Balance Sheet will be merged with the Head Office Balance Sheet in the same manner as that set out in the example on page 205.

EXAMPLE 7. Convert the following Trial Balance into sterling—

NEW YORK TRIAL BALANCE
30TH JUNE, 19..

	Dr. Dols.	Dr. Cts.	Cr. Dols.	Cr. Cts.
Purchases	14,742	64		
Sales			24,631	33
Debtors	3,961	32		
Creditors			5,745	—
Fixtures	1,062	—		
Bills Receivable	2,849	65		
Discounts	110	15		
Wages and Salaries	2,869	72		
Rent and Rates	750	—		
Bad Debts	375	76		
General Expenses	185	55		
Depreciation	250	—		
Stock, 1st July	3,750	89		
Head Office Account, 1st July			16,498	—
Remittances to Head Office	12,600	—		
Insurance	340	80		
Cash	150	25		
Bank	2,875	60		
	46,874	33	46,874	33

Stock, 31st December, $2,400.
Rate of Exchange ruling, 1st January, 4.21.
" " " 31st December, 4.09.
Average rate for period of accounts, 4.15.
Rate when Fixtures were acquired, 4.65.

In the Head Office books, the Branch Account and the Remittances Account appear as £3,928 3s. 4d. and £3,001 1s. 11d. respectively.

NEW YORK TRIAL BALANCE

30TH JUNE, 19..

	Rate of Conversion	*Dr.* £	s.	d.	*Cr.* £	s.	d.
Purchases . .	4.15	3,552	8	11			
Sales . . .	4.15				5,935	5	3
Debtors . . .	4.09	968	10	9			
Creditors . .	4.09				1,404	12	11
Fixtures . . .	4.65	228	7	8			
Bills Receivable .	4.09	696	14	9			
Discounts . .	4.15	26	10	10			
Wages and Salaries .	4.15	691	10	–			
Rent and Rates .	4.15	180	14	5			
Bad Debts . .	4.15	90	10	11			
General Expenses .	4.15	44	14	2			
Depreciation . .	4.15	60	4	10			
Stock, 1st July .	4.21	890	19	-			
Head Office Account, 1st July . .					3,928	3	4
Remittances to H.O.		3,001	1	11			
Insurance . .	4.15	82	2	5			
Cash . . .	4.09	36	14	9			
Bank . . .	4.09	703	1	8			
Difference in Exchange (loss) . .		13	14	6			
		£11,268	1	6	£11,268	1	6

Stock, 31st December, at 4.09, £586 16s.

EXERCISE VIII

A. Into what classes may Branch Accounts be divided? Give a brief description of each.

B. Smith opens three branches, in Manchester, Liverpool, and Leeds. Give the entries he will make in his books when goods are transferred to the branches from stock, and submit a suitable ruling for his "Branch Supplies Book."

C. What do you understand by "interim stock accounts"? Give an example of these accounts and use your own figures.

D. A manufacturing company is about to open a number of suburban shops, the managers of which will be authorized to give credit to suitable customers. You are required to sketch a form of printed Return to be completed by each branch and sent to Head Office daily or weekly. (C.R.A.)

E. From the following particulars compile a Branch Account as it would appear in the books of Head Office—

	£	s.	d.
Goods from Head Office	3,162	4	1
Goods returned to Head Office	22	10	6
Rates and Taxes	14	15	1
Wages and Salaries	276	12	–
Remittances to Head Office	4,164	10	6
Stock (opening)	899	7	5
Stock (closing)	1,016	14	–
General Expenses	27	5	6

F. From the figures given below prepare a Branch Account in the Head Office books. The goods sent to the branch have been invoiced at 25 per cent on cost—

	£	s.	d.
Goods from Head Office	4,561	10	–
Purchases (local)	4,195	5	–
Wages	420	16	10
Remittances to Head Office	9,162	10	4
Insurance	15	15	–
Rent	150	–	–
Opening Stock	856	10	5
Closing Stock	1,164	16	–

Of the closing stock, £586 10s. 7d. represented stock of goods purchased locally.

G. How may the approximate accuracy of branch stocks be assessed if goods sent to branches are charged out at selling price? Submit a ruling of the Branch Supplies Book giving details of both cost and invoice prices.

H. A firm consists of four branches, A, B, C, and D. The standard rate of profit is fixed for each branch at 20 per cent, 15 per cent, 10 per cent, and 25 per cent respectively. From the following figures compile an Interim Stock Account—

	A	B	C	D
	£	£	£	£
Stock (opening)	6,421	3,896	7,214	8,392
Purchases	10,741	8,692	10,050	12,691
Sales	14,645	12,720	15,300	16,784

I. Green and Gold have branches at Sheffield, York, and Leeds. The standard rate of profit on selling price is fixed at

25 per cent Sheffield, 16 per cent York, and 30 per cent Leeds. From the following figures prepare a summary of the estimated stock in hand at each branch—

	Sheffield	York	Leeds
	£	£	£
Stock (opening)	15,642	8,316	10,896
Goods supplied	25,816	14,321	19,315
Sales	40,264	15,150	37,690

J. The undermentioned figures relate to a branch conducting both cash and credit sales—

	£	s.	d.
Goods from Head Office	3,675	14	10
Returns to Head Office	15	19	–
Returns from Customers	40	16	5
Sales, Cash	2,916	10	–
Sales, Credit	1,614	14	6
Debtors, opening balance	89	14	2
Debtors, closing balance	128	4	8
Stock (opening)	679	15	6
Stock (closing)	872	19	6
Rent	250	–	–
Insurance	14	10	–
Commission	48	16	9
Wages	156	18	9
Discount	19	17	7
General Expenses	68	14	–
Cash from Debtors	1,515	10	–

Prepare a Branch Account in the Head Office books, and calculate the final result by means of a Branch Profit and Loss Account.

K. The National Trading Co. established a branch at Bristol which was allowed to conduct credit business in addition to the usual cash sales. From the following balances at 31st December, 19.., compile a separate Branch Account for Goods supplied, Expenses, and Debtors, and show the final trading result of the branch by means of a Profit and Loss Account—

	£	s.	d.
Goods from Head Office	4,879	3	2
Returns (Head Office)	26	4	10
Returns (Customers)	14	9	6
Sales (Cash)	3,042	10	4

	£	s.	d.
Sales (Credit)	2,816	15	–
Discounts	24	17	6
Rates	12	12	–
Stock, 1st January	450	9	9
Stock, 31st December	1,006	14	5
Debtors, 1st January	125	16	–
Debtors, 31st December	261	5	–
Cash from Debtors	2,641	19	–
Wages	241	11	6
Manager's Salary	350	–	–
Sundry Expenses	89	14	10

L. The following Trial Balance has been received from the Nottingham Branch of the Norton Manufacturing Co., as at 31st December, 19... You are required to write up the accounts in the books at the branch and at Head Office, and to draw up final accounts for the branch.

	£	s.	d.	£	s.	d.
Purchases	2,136	15	7			
Supplies from Head Office	3,639	16	5			
Stock, 1st January	1,751	8	2			
Sales				9,143	8	11
Sundry Debtors	1,250	12	6			
Discount	62	1	–			
Sundry Creditors				115	9	3
Wages	1,015	3	–			
Commission	148	10	9			
Salaries	300	–	–			
Remittances to Head Office	1,500	–	–			
Fixtures	150	–	–			
Cash	126	14	10			
Rent and Taxes	490	17	–			
Head Office Account, 1st January				3,313	1	1

Stock, 31st December, £2,026 8s. 7d.

M. The London and Westminster Grocery Co., Ltd., has a retail branch in Manchester which is supplied with all goods from London. The branch shop keeps its own Sales Ledger, receives cash against Ledger Accounts, and remits the whole of the cash received daily to the Head Office. All wages and branch expenses are drawn for by cheque weekly from the Head Office upon the imprest system.

From the undermentioned particulars supplied by the Branch manager, show how the Branch Accounts would appear in the

Head Office books, and prepare a Profit and Loss Account for the branch shop for the six months to 31st December—

	£
Six Months' Credit Sales	2,387
Returns Inwards	20
Cash Received on Ledger Accounts . .	2,384
Cash Sales	1,214
Stock, 1st July	720
Stock, 31st December	1,121
Debtors, 1st July	1,227
Goods received from Head Office . . .	2,178
Rent, Taxes, etc., paid	375
Wages and Sundry Expenses paid . . .	396

(L.C.C.)

N. Messrs. Baxton & Sons, whose Head Office is in London, remitted £500 to their Manchester Branch on 30th December. The books of the Head Office and the Branch are balanced as on 31st December each year. The above-mentioned remittance did not reach Manchester until the morning of the 1st January. How would you deal with the amount in question in the Trial Balances of the Head Office and Branch, and when preparing the combined Balance Sheet of the whole business? (L.C.C.)

O. The Manufacturing Co., Ltd., has a nominal capital of 15,000 shares of £10 each, and a subscribed capital of 8,000 shares fully paid up. It manufactures goods for sale at its two branches, A and B, which sell no goods other than those of the company's manufacture. From the Trial Balance on page 222, extracted from the books of the Head Office and Branches as on 31st December, prepare, for submission to the Directors, Trading and Profit and Loss Accounts for the Head Office, and for each of the Branches for the year ended 31st December, and a Balance Sheet of the company as a whole as on that date. Stocks on hand as on 31st December were—

	£	s.	d.
Head Office	10,527	4	5
Branch A	3,024	12	1
Branch B	1,927	9	4

Write off the following depreciations—

Head Office Plant and Machinery . . .	10 per cent
Furniture and Fixtures, Head Office . .	5 ,, ,,
,, ,, ,, Branch A . . .	5 ,, ,,
,, ,, ,, Branch B . . .	5 ,, ,,

Create a reserve for Bad Debts of 2½ per cent on the Sundry

Debtors. Write off £5,000 from Goodwill, and carry £10,000 to Reserve. All carriage on the goods sent to the Branches is paid by the Head Office. (R.S.A.)

P. Dicksons, Ltd., whose Head Office is in London, opened a Branch in Exeter. All goods were supplied from the Head Office at cost *plus* 20 per cent. During the three months ended 31st December, 19.., the following transactions took place—

	£
Goods supplied to Branch at Cost	10,000
Cash Sales at Branch	5,850
Credit Sales at Branch	3,460
Cash received from Branch Debtors . . .	3,000
Goods returned by Branch to Head Office . .	60
Closing Stock at Branch (at Invoice Price) . .	3,600

Submit the accounts necessary to record the above transactions in the Head Office books. (R.S.A.)

Q. Explain why, where a concern has a branch or carries on part of its business abroad, a figure called "difference on exchange" usually arises. State how this figure should be dealt with when closing the books under various circumstances, assuming that the exchange rate with the foreign country in question is—

(*a*) "Stable."
(*b*) "Unstable." (C.A.A.)

R. In cases where questions of foreign exchange are involved, state *two* different methods of recording transactions with a foreign branch. (R.S.A.)

S. When dealing with the annual accounts of a foreign branch situated in a stable exchange country, how would you deal with the credit balance of the "Profit and Loss on Exchange Account"? (R.S.A.)

T. Convert—

(*a*) £376 15s. 6d. into francs and centimes @ 95.25 francs to the £.

(*b*) £496 17s. 5d. into dollars and cents @ 4.86⅝ dollars to the £.

(*c*) £187 12s. 3d. into marks and pfennige @ 20.43 marks to the £.

(*d*) £963 2s. 10d. into francs and centimes @ 124.21 francs to the £.

THE MANUFACTURING CO., LTD.

	Dr. Head Office	*Dr.* Branch A	*Dr.* Branch B	*Cr.* Head Office	*Cr.* Branch A	*Cr.* Branch B
	£ s. d.	£ s. d.	£ s. d.	£ s. d.	£ s. d.	£ s. d.
Freehold Premises—						
Head Office	40,000 – –					
Branch A	10,000 – –					
Branch B	10,000 – –					
Goodwill	30,000 – –					
Plant and Machinery	8,000 – –					
Furniture and Fixtures—						
Head Office	500 – –					
Branch A	700 – –					
Branch B	800 – –					
Cash at Bank	6,790 1 6					
Cash in Hand	14 7 2	83 2 9	38 9 5			
Stock, 1st January	11,245 5 1	2,812 3 7	1,994 17 6			
Purchases (*less* Returns)	65,090 5 11					
Wages	39,651 1 11	2,419 – –	2,622 3 4			
Salaries	1,500 – –	247 14 4	276 6 6			
Carriage to Branches	1,516 14 7					
Rates and Taxes	323 2 9	442 6 7	328 14 4			
Goods to Branch A		94,167 2 3		94,167 2 3		
Goods to Branch B			44,267 – 2	44,267 – 2		
Sales (*less* Returns)					112,517 – 2	53,540 3
General Expenses	517 9 2	2,016 4 6	1,796 6 8			
Bad Debts		1,552 8 2	746 17 11			
Sundry Debtors		9,620 2 9	5,370 3 2			
Sundry Creditors				11,247 13 2	541 6 6	547 12 1
Branch Current Account—						
Branch A	301 18 3					
Branch B	3,353 – 8					
Head Office Current Account					301 18 3	3,353 – 8
Income Tax[1]	447 10 8					
Directors' Fees[1]	1,000 – –					
Audit Fee[1]	105 – –					
Share Capital				80,000 – –		
Profit and Loss Account (Balance)				2,174 2 1		
	£231,855 17 8	£113,360 4 11	£57,440 19 –	£231,855 17 8	£113,360 4 11	£57,440 19 –

[1] No apportionment of these items need be made.

U. Convert the following Trial Balance into sterling—

BOMBAY BRANCH, 30TH JUNE, 19..

	Dr.	*Cr.*
	Rs.	Rs.
Head Office Account		21,400
Remittances Account	14,000	
Bills Receivable	7,000	
Bills Payable		10,500
Stock on hand, 1st January . . .	10,000	
Purchases	22,000	
Sales		38,000
Wages and Salaries	1,800	
Rent, Rates, and Insurance . . .	1,500	
General Expenses	1,600	
Sundry Debtors	40,000	
Sundry Creditors		30,000
Cash at Bank	1,500	
Cash in Hand	500	
Rs.	99,900	99,900

Stock on hand, 30th June, Rs. 6,000

The rate of exchange has been as follows: 1st January, 15.$\frac{31}{32}$nds; 30th June, 16.$\frac{1}{32}$nd. Average for period, say, 16. The Head Office and Remittances Accounts appeared in the Head Office books at £1,336 and £871 respectively.

V. From the foregoing particulars relating to an Indian Branch, prepare Branch Trading and Profit and Loss Accounts, and a Balance Sheet in sterling. When preparing the Profit and Loss Accounts, create a reserve of £150 for bad debts.

W. Messrs. Pernet Ducher & Co., Ltd., London, have a branch office in a South American Republic, where the exchange fluctuations are considerable. The books of the branch are kept in local currency only, and, at the close of each financial year, a Trial Balance, Profit and Loss Account, and Balance Sheet are sent to the London office. Briefly describe how you would amalgamate the branch figures with those of the Head Office. At what rates would you convert (1) the Profit and Loss Account balance, (2) the Floating Assets, (3) the Fixed Assets, (4) Remittances from London? (L.C.C.)

X. Convert—

(*a*) 4,987.45 francs into sterling, at 124.25.
(*b*) 8,784.34 dollars into sterling, at 4.85$\frac{1}{8}$.
(*c*) 2,135.5 marks into sterling, at 20.41.

CHAPTER IX

SELF-BALANCING LEDGERS

No difficulty should be experienced in balancing the ledger when the number of business transactions is small, or when the majority of the dealings are made in cash, but should the volume of credit business be large, and, as a result the ledger be divided into several sections, the balancing of these at the end of the financial year may occasion considerable difficulty. To avoid this and, to some extent, hasten the preparation of the Trading and Profit and Loss Account, which can easily be delayed when books cannot be made to agree, the system of self-balancing ledgers may be introduced. The introduction of this system is accompanied with but little extra expense and the corresponding advantages to be derived from its use are many. Simply stated, the fundamental principle is that each ledger contains within itself a complete record of the twofold aspect of all the transactions with which it deals, and, as a result, a trial balance can be prepared for each particular ledger.

The location of errors where ledgers are not self-balancing can cause great difficulty and involve a deal of time, and so it is chiefly with a view to facilitating the work of the ledger clerk that the system is inaugurated. Although this is the chief object, there are several others, namely—

1. Each ledger of the firm becomes a complete unit; it may be balanced as frequently as is desired without reference to the other books.

2. Errors are localized and may receive early correction because periodical testings may be made with ease and rapidity.

3. A good check is maintained on the work of those responsible for the compilation of the ledgers.

4. Completeness of the ledgers enables the final accounts to be prepared immediately after the close of the trading year.

The Adjustment Account.

Ledgers compiled in the usual way show only one side of each of the business dealings, the contra aspect appearing in one or more of the subsidiary books, and when posting has been completed, it is possible to extract a schedule of the balances which are either debit or credit according to the nature of the particular ledger. This list of balances will not, however, reveal an error if one has occurred in its compilation. In order to contain the "twofold aspect of each transaction" within the ledger itself, an account is included at the end of each ledger (or its subdivision) which is termed an "Adjustment Account." This account contains, in a summarized form, the totals of the items which appear in the individual ledger accounts. The debits and credits are, however, transposed; the total of the items appearing on the debit side of the individual accounts is shown on the credit side of the Adjustment Account, and the total of those appearing on the credit side of the ledger accounts is shown on the debit side of the Adjustment Account. The total of the balances outstanding at any particular time in the individual accounts should, therefore, agree with the balance of the Adjustment Account. But where, in the ordinary way, it would be necessary to check the whole of the ledger entries, the system of self-balancing ledgers draws attention to the particular ledger in which the error may have arisen. Thus, in the General Ledger, adjustment accounts will be opened for both the Bought and Sales Ledgers, headed "Bought Ledger Adjustment Account," and "Sales Ledger Adjustment Account." The counterpart of these two accounts will appear in the Bought and Sales Ledgers, headed "General Ledger Adjustment Account."

The Adjustment Account is, in effect, a Total Debtors' or Total Creditors' Account, a term by which it was known before the more dignified title of "Adjustment Account" was introduced. The Sales Ledger will consist of such items as sales of goods, goods returned, cash received in settlement of accounts, discount, etc., and a summary of these items will have the following appearance.

Debtors	Goods Sold	Returns	Cash Received	Dis-count	Balances Owing
	£	£	£	£	£
Brown . .	416	51	305	15	45
Smith . .	356	6	340	10	—
Jones . .	271	—	100	5	166
Clark . .	544	22	360	20	142
Buxton . .	199	5	50	—	144
	£1,786	£84	£1,155	£50	£497

If these totals are transferred to a Total Debtors' Account, the student will be able to understand the method of making each ledger self-balancing.

Dr. TOTAL DEBTORS' ACCOUNT *Cr.*

	To Goods . . .		£ 1,786		By Returns . . . ,, Cash . . . ,, Discount . . ,, Balance . . .		£ 84 1,155 50 497
			£1,786				£1,786

Thus, the accuracy of the ledger postings is proved because the total of the summarized debtors' accounts agrees with the individual balances in the Sales Ledger. To deal with the preparation of the Adjustment Accounts, which are compiled on the same lines, let us take the Bought Ledger as an example. At the back of this ledger will be included an account called "The General Ledger Adjustment Account." The various accounts in this ledger will be made up of some or all of the following entries—

Debit Side	*Credit Side*
Returns	Balances b/d
Cash paid	Purchases
Discount received	
Bills Payable	
Balances c/d	

The total of these items is posted from the various subsidiary books to the General Ledger Adjustment Account in the following manner—

Dr. GENERAL LEDGER ADJUSTMENT ACCOUNT *Cr.*

			£ s. d.				£ s. d.
	To Balances b/d		– – –		By Returns		– – –
	,, Purchases		– – –		,, Cash		– – –
					,, Discount		– – –
					,, Bills Payable		– – –
					,, Balances c/d		– – –
			– – –				– – –
	To Balances b/d		– – –				

The Adjustment Account in the General Ledger (the counterpart of that appearing in the Bought Ledger) would be shown thus—

Dr. BOUGHT LEDGER ADJUSTMENT ACCOUNT *Cr.*

			£ s. d.				£ s. d.
	To Returns		– – –		By Balances b/d		– – –
	,, Cash		– – –		,, Purchases		– – –
	,, Discount		– – –				
	,, Bills Payable		– – –				
	,, Balances c/d		– – –				
			– – –				– – –
					By Balances b/d		– – –

The Sales Ledger would be similarly treated. In this case, the individual debtors' accounts would consist of the following entries—

Debit Side	*Credit Side*
Balances b/d	Cash received
Sales	Discount allowed
	Bills Receivable
	Returns
	Bad Debts
	Balances c/d

The total of these items would be posted from the subsidiary books to the General Ledger Adjustment Account (in the Sales Ledger) thus:

Dr. GENERAL LEDGER ADJUSTMENT ACCOUNT *Cr.*

		£ s. d.			£ s. d.
	To Cash . . .	- - -		By Balances b/d .	- - -
	,, Discount . .	- - -		,, Sales . . .	- -
	,, Bills Receivable .	- - -			
	,, Returns . .	- - -			
	,, Bad Debts . .	- - -			
	,, Balances c/d .	- - -			
		- - -			- - -
				By Balances b/d .	- - -

and the Sales Ledger Adjustment Account in the General Ledger would appear as under—

Dr. SALES LEDGER ADJUSTMENT ACCOUNT *Cr.*

		£ s. d.			£ s. d.
	To Balances b/d .	- - -		By Cash . . .	- - -
	,, Sales . . .	- - -		,, Discount . .	- - -
				,, Bills Receivable .	- - -
				,, Returns . .	- - -
				,, Bad Debts . .	- - -
				,, Balances c/d .	- - -
		- - -			- - -
	To Balances b/d .	- - -			

From the foregoing it will be observed that, strictly speaking, there is no necessity to open two sets of adjustment accounts. To achieve the purpose of the self-balancing principle, it is necessary to open only an adjustment account for each Bought and Sales Ledger, which may be included in the General Ledger. The value of ledger self-balancing lies in the fact that the personal accounts in the Bought and Sales Ledgers are written up from the *individual* items appearing in the subsidiary books, whereas the adjustment accounts contain only the *totals* of these books. Thus, if an item of £100 has been posted from the Purchases Book to a personal account in the Bought Ledger as £10, and the Purchases Book has been correctly totalled, this error will be instantly revealed when the adjustment account is prepared, provided a compensating error of a like amount has not been made.

The student is advised to make quite sure that the theoretical side of the self-balancing principle is understood before the

following example is perused. Many students are apt to find the principle of ledger self-balancing rather difficult to grasp, and, rather than make further efforts to complete their knowledge by carefully re-reading the whole of the text, they glance rapidly through an example given and gain a somewhat false impression that they have mastered the problem before them—an impression sometimes proved to be hasty when it is too late to revise!

EXAMPLE 1. Percy Philips is in business as a wholesale draper and costumier, and his position at 31st March was as follows—

	£
Capital	2,500
Premises	1,000
Stock	850
Fixtures	150
Debtors—	
G. Griffiths	169
T. Green	301
Creditors—	
J. Robinson	258
B. Brown	74
Petty Cash	50
Cash at Bank	312

His transactions during April were—

April 1. Bought of B. Brown—
12 doz. Scarves at 4s. 3d. each.
6 doz. beaded Trimmings at 5s. 3d. per doz.

4. Bought of S. James—
20 Costumes at 50s. each.
75 yd. Jap Silk at 3s. 1d. per yard.
Paid Wages, £65.
Sundry Cash Purchases, £15 15s. 3d.

6. Sold to G. Griffiths—
100 pairs Silk Stockings at 4s. 6d. per pair.
10 Costumes at 65s. each.

7. Returned 12 Scarves to B. Brown (damaged).

8. Sold to T. Green—
35 yd. Velvette at 6s. 11d. per yard.
10 yd. Coating Serge at 1s. 11d. per yard.

9. G. Griffiths returned 20 pairs Silk Stockings.

10. Bought of J. Robinson—
15 Velour Costumes at 2 guineas each.

11. Cash Sales to date, £45.
Paid Wages, £59.

April 13. Sold to G. Griffiths—
25 yd. Coating Serge at 2s. 5d. per yard.
Returned to S. James, 2 Costumes.
15. Purchased new Showcase, £15.
Received from G. Griffiths, £159, Discount, £10.
16. Paid J. Robinson £200 on account.
17. Sold to T. Green—
1 doz. Scarves at 5s. 9½d. each.
50 pairs Silk Stockings at 5s. 1d. per pair.
18. Paid S. James his account, Discount, £4 15s.
Cash Sales to date, £39 15s.
Paid Wages, £61 15s.
20. Received from T. Green, £295, Discount, £6.
23. Bought of S. James—
40 Costumes at 50s. each.
Sundry Cash Purchases, £28 10s.
24. Paid B. Brown, £69 15s., Discount, £4 5s.
25. Cash Sales to date, £59.
Paid Wages, £58 15s.
27. Sold to C. Clarke—
50 yd. Velvette at 6s. 11d. per yard.
Sold to T. Green—
20 Costumes at 75s. each.
28. Received from T. Green, £25 9s. 9d., Discount, £3 15s.
Received from G. Griffiths, £50 on account.
29. C. Clarke returned 5 yd. Velvette (unfit for sale).

All cash receipts are paid into the bank the same day, and all payments are made by cheque.

The Petty Cash transactions were—

		£	s.	d.
April 4.	Carriage	15	4	6
11.	Insurance	1	15	6
16.	Postage	2	10	–
20.	Carriage	2	5	6
23.	Rates	5	10	–
	Postage	2	10	–
27.	Trade Expenses	4	10	–
	Insurance		16	–
30.	Postage	2	–	–
	Fares	1	2	6

From the above particulars write up the Purchases, Sales and Returns Books, the Cash, and Petty Cash Books. Post all items to the appropriate Ledgers on the self-balancing principle, and extract Trial Balance.

Dr. CASH BOOK (RECEIPTS)

	Particulars	Fol.	Discount	Bank	Bought Ledger	Sales Ledger	General Ledger
			£ s. d.	£ s. d.	£ s. d.	£ s. d.	£ s. d.
Apr. 1	To Balance . . .			312 – –			
11	,, Cash Sales . . .			45 – –			45 – –
15	,, G. Griffiths . . .		10 – –	159 – –		169 – –	
18	,, Cash Sales . . .			39 15 –			39 15 –
20	,, T. Green . . .		6 – –	295 – –		301 – –	
25	,, Cash Sales . . .			59 – –			59 – –
28	,, T. Green . . .		3 15 –	25 9 9		29 4 9	
	,, G. Griffiths . . .			50 – –		50 – –	
			£19 15 –	£985 4 9		£549 4 9	£143 15 –
May 1	To Balance b/d . . .			321 14 3			

CASH BOOK (PAYMENTS) *Cr.*

	Particulars	Fol.	Discount	Bank	Bought Ledger	Sales Ledger	General Ledger
			£ s. d.	£ s. d.	£ s. d.	£ s. d.	£ s. d.
19.. Apr. 4	By Wages			65 – –			65 – –
	,, Cash Purchases . .			15 15 3			15 15 3
11	,, Wages			59 – –			59 – –
15	,, Fixtures . . .			15 – –			15 – –
16	,, J. Robinson . . .			200 – –	200 – –		
18	,, S. James . . .		4 15 –	51 16 3	56 11 3		
	,, Wages			61 15 –			61 15 –
23	,, Cash Purchases . .			28 10 –			28 10 –
24	,, B. Brown . . .		4 5 –	69 15 –	74 – –		
25	,, Wages			58 15 –			58 15 –
30	,, Petty Cash . . .			38 4 –			38 4 –
	,, Balance c/d . . .			321 14 3			
			£9 – –	£985 4 9	£330 11 3		£341 19 3

Dr. PETTY CASH BOOK *Cr.*

Cash Received		Particulars	Fol.	Total	Carriage	Insurance	Postage	Rates	Sundries
£ s. d.	19..			£ s. d.	£ s. d.	£ s. d.	£ s. d.	£ s. d.	£ s. d.
50 – –	Apr. 1	Balance . .							
	4	Carriage . .		15 4 6	15 4 6				
	11	Insurance .		1 15 6		1 15 6			
	16	Postage . .		2 10 –			2 10 –		
	20	Carriage . .		2 5 6	2 5 6				
	23	Rates . .		5 10 –				5 10 –	
		Postage . .		2 10 –			2 10 –		
	27	Trade Expenses		4 10 –					4 10 –
		Insurance .		16 –		16 –			
	30	Postage . .		2 – –			2 – –		
		Fares . .		1 2 6					1 2 6
				38 4 –	£17 10 –	£2 11 6	£7 – –	£5 10 –	£5 12 6
38 4 –	30	Cheque (Cash Book) . .							
		Balance c/d .		50 – –					
£88 4 –				£88 4 –					
50 – –	May 1	Balance b/d							

PURCHASES BOOK

	Particulars	Fol.	Total of Invoice		
19..			£	s.	d.
Apr. 1	B. Brown		32	3	6
4	S. James		61	11	3
10	J. Robinson		31	10	–
23	S. James		100	–	–
			£225	4	9

SALES BOOK

	Particulars	Fol.	Total of Invoice		
19..			£	s.	d.
Apr. 6	G. Griffiths		55	–	–
8	T. Green		13	1	3
13	G. Griffiths		3	–	5
17	T. Green		16	3	6
27	C. Clarke		17	5	10
	T. Green		75	–	–
			£179	11	–

PURCHASES RETURNS BOOK

	Particulars	Fol.			
19..			£	s.	d.
Apr. 7	B. Brown		2	11	–
13	S. James		5	–	–
			£7	11	–

SALES RETURNS BOOK

	Particulars	Fol.	
19..			£ s. d.
Apr. 9	G. Griffiths		4 10 –
29	C. Clarke		1 14 7
			£6 4 7

BOUGHT OR CREDITORS' LEDGER

Dr. J. Robinson *Cr.*

19..		£ s. d.	19..			£ s. d.
Apr. 16	To Bank .	200 – –	Apr. 1	By Balance .	.	258 – –
			10	,, Goods .	.	31 10 –

Dr. B. Brown *Cr.*

19..		£ s. d.	19..			£ s. d.
Apr. 7	To Returns .	2 11 –	Apr. 1	By Balance .		74 – –
24	,, Cash . .	69 15 –		,, Goods .	.	32 3 6
	,, Discount . .	4 5 –				

Dr. S. James *Cr.*

19..		£ s. d.	19..			£ s. d.
Apr. 13	To Returns . .	5 – –	Apr. 4	By Goods .	.	61 11 3
18	,, Cash . .	51 16 3	23	,, ,, .	.	100 – –
	,, Discount . .	4 15 –				

Dr. GENERAL LEDGER ADJUSTMENT ACCOUNT *Cr.*

19..		£ s. d.	19..			£ s. d.
Apr. 1	To Balance .	. 332 – –	Apr. 30	By Returns .	.	7 11 –
30	,, Purchases	. 225 4 9		,, Cash .	.	321 11 3
				,, Discount .	.	9 – –
				,, Balance c/d	.	219 2 6
		£557 4 9				£557 4 9
May 1	To Balance b/d	. 219 2 6				

SALES OR DEBTORS' LEDGER

Dr. G. GRIFFITHS *Cr.*

Date		£	s.	d.	Date		£	s.	d.
19..					19..				
Apr. 1	To Balance . .	169	–	–	Apr. 9	By Returns . .	4	10	–
6	,, Goods . .	55	–	–	15	,, Cash . .	159	–	–
13	,, ,, . .	3	–	5		,, Discount . .	10	–	–
					28	,, Cash . .	50	–	–

Dr. T. GREEN *Cr.*

Date		£	s.	d.	Date		£	s.	d.
19..					19..				
Apr. 1	To Balance .	301	–	–	Apr. 20	By Cash . .	295	–	–
8	,, Goods . .	13	1	3		,, Discount . .	6	–	–
17	,, ,, .	16	3	6	28	,, Cash . .	25	9	9
27	,, ,, . .	75	–	–		,, Discount . .	3	15	–

Dr. C. CLARKE *Cr.*

Date		£	s.	d.	Date		£	s.	d.
19..					19..				
Apr. 27	To Goods . .	17	5	10	Apr. 29	By Returns . .	1	14	7

Dr. GENERAL LEDGER ADJUSTMENT ACCOUNT *Cr.*

Date		£	s.	d.	Date		£	s.	d.
19..					19..				
Apr. 30	To Returns . .	6	4	7	Apr. 1	By Balance . .	470	–	–
	,, Cash . .	529	9	9	30	,, Sales . .	179	11	–
	,, Discount . .	19	15	–					
	,, Balance c/d .	94	1	8					
		£649	11	–			£649	11	–
					May 1	By Balance b/d .	94	1	8

GENERAL LEDGER

Dr. PERCY PHILIPS *Cr.*

Date		£	s.	d.	Date		£	s.	d.
19..					19..				
					Apr. 1	By Balance . .	2500	–	–

Dr. PREMISES *Cr.*

Date		£	s.	d.	Date		£	s.	d.
19..					19..				
Apr. 1	To Balance . .	1000	–	–					

Dr. FIXTURES *Cr.*

			£	s.	d.				£	s.	d.
19..						19..					
Apr.	1	To Balance . .	150	–	–						
	15	,, Cash . .	15	–	–						

Dr. STOCK *Cr.*

			£	s.	d.				£	s.	d.
19..						19..					
Apr.	1	To Balance . .	850	–	–						

Dr. PURCHASES *Cr.*

			£	s.	d.				£	s.	d.
19..						19..					
Apr.	4	To Cash . .	15	15	3						
	23	,, ,, . .	28	10	–						
	30	,, Sundries . .	225	4	9						

Dr. PURCHASES RETURNS *Cr.*

			£	s.	d.				£	s.	d.
19..						19..					
						Apr.	30	By Sundries . .	7	11	–

Dr. SALES *Cr.*

			£	s.	d.				£	s.	d.
19..						19..					
						Apr.	4	By Cash . .	45	–	–
							18	,, ,, . .	39	15	–
							25	,, ,, . .	59	–	–
							30	,, Sundries . .	179	11	–

Dr. SALES RETURNS *Cr.*

			£	s.	d.				£	s.	d.
19..						19..					
Apr.	30	To Sundries . .	6	4	7						

Dr. DISCOUNT ALLOWED *Cr.*

			£	s.	d.				£	s.	d.
19..						19..					
Apr.	30	To Sundries . .	19	15	–						

Dr. DISCOUNT RECEIVED *Cr.*

19..			£ s. d.	19..			£ s. d.
				Apr. 30	By Sundries . .		9 – –

Dr. WAGES *Cr.*

19..			£ s. d.	19..			£ s. d.
Apr. 4	To Cash . .		65 – –				
11	,, ,, . .		59 – –				
18	,, ,, . .		61 15 –				
25	,, ,, . .		58 15 –				

Dr. CARRIAGE *Cr.*

19..			£ s. d.	19..			£ s. d.
Apr. 4	To Cash .		15 4 6				
21	,, ,, . .		2 5 6				

Dr. INSURANCE *Cr.*

19..			£ s. d.	19..			£ s. d.
Apr. 11	To Cash . .		1 15 6				
30	,, ,, . .		16 –				

Dr. POSTAGE *Cr.*

19..			£ s. d.	19..			£ s. d.
Apr. 16	To Cash . .		2 10 –				
23	,, ,, . .		2 10 –				
30	,, , . .		2 – –				

Dr. RATES *Cr.*

19..			£ s. d.	19..			£ s. d.
Apr. 30	To Cash . .		5 10 –				

Dr. SUNDRY EXPENSES *Cr.*

19..			£ s. d.	19..			£ s. d.
Apr. 27	To Cash . .		4 10 –				
30	,, ,, . .		1 2 6				

Dr. BOUGHT LEDGER ADJUSTMENT ACCOUNT *Cr.*

			£	s.	d.				£	s.	d.
19..						19..					
Apr. 30	To Returns .		7	11	–	Apr. 1	By Balance .		332	–	–
	,, Cash .		321	11	3	30	,, Purchases		225	4	9
	,, Discount .		9	–	–						
	,, Balance c/d		219	2	6						
			£557	4	9				£557	4	9
						May 1	By Balance b/d		219	2	6

Dr. SALES LEDGER ADJUSTMENT ACCOUNT *Cr.*

			£	s.	d.				£	s.	d.
19..						19..					
Apr. 1	To Balance .		470	–	–	Apr. 30	By Returns .		6	4	7
30	,, Sales .		179	11	–		,, Cash .		529	9	9
							,, Discount .		19	15	–
							,, Balance c/d		94	1	8
			£649	11	–				£649	11	–
May 1	To Balance b/d		94	1	8						

TRIAL BALANCE. 30TH APRIL

	Dr. £	s.	d.	*Cr.* £	s.	d.
P. Philips, Capital				2,500	–	–
Premises	1,000	–	–			
Fixtures	165	–	–			
Stock	850	–	–			
Purchases	269	10	–			
Sales				323	6	–
Purchases Returns				7	11	–
Sales Returns	6	4	7			
Wages	244	10	–			
Carriage	17	10	–			
Insurance	2	11	6			
Postage	7	–	–			
Discount Allowed	19	15	–			
Discount Received				9	–	–
Rates	5	10	–			
Sundry Expenses	5	12	6			
Petty Cash	50	–	–			
Bank	321	14	3			
Bought Ledger Adj'tment A/c (or Sundry Creditors)				219	2	6
Sales Ledger Adjustment A/c (or Sundry Debtors)	94	1	8			
	£3,058	19	6	£3,058	19	6

Where the number of ledger accounts is large, it is usual to extract a trial balance for each ledger. The individual balances in the Bought and Sales Ledgers are scheduled, the total of which should agree with the balances of the Adjustment Accounts in the General Ledger. Specimen trial balances are given below.

TRIAL BALANCE—BOUGHT LEDGER
30TH APRIL

		Dr. £	s.	d.	Cr. £	s.	d.
J. Robinson					89	10	–
B. Brown					29	12	6
S. James					100	–	–
General Ledger Adjustment Account		219	2	6			
	£	219	2	6	£219	2	6

TRIAL BALANCE—SALES LEDGER
30TH APRIL

		Dr. £	s.	d.	Cr. £	s.	d.
G. Griffiths		3	10	5			
T. Green		75	–	–			
C. Clarke		15	11	3			
General Ledger Adjustment Account					94	1	8
		£94	1	8	£94	1	8

Many accountants doubt the utility of the opening of adjustment accounts in the Purchases and Sales Ledgers, and argue that the only adjustment accounts necessary are those for the General Ledger. When this plan is adopted, two accounts only are opened in the General Ledger (or more, if several ledgers are employed) which are really Total Debtor and Total Creditor Accounts. These accounts will assume a form similar to the Purchases and Sales Ledger Adjustment

Accounts already discussed and illustrated. The distinct advantage of this method is that complete control and supervision are maintained over the ledger clerks who have no hand in the preparation of the adjustment accounts, which are made up direct from the entries in the subsidiary books. Risk of fraudulent manipulation is thus considerably reduced. At certain stipulated intervals those responsible for the compilation of the ledgers will submit a summary of the balances appearing in their ledgers to the chief clerk or accountant, and these can then be compared with the balances appearing in the Adjustment Accounts in the General Ledger.

In those cases in which several Purchases and Sales Ledgers are in use, it will be necessary to rule the subsidiary books in such a manner that direct analysis can be made. Specimen subsidiary books ruled with analysis columns appear on pages 242–3. The use of extra columns is not, however, always convenient. Where the ledgers employed are so numerous as to make the ruling of subsidiary books too cumbersome, it is usual to compile analysis sheets from the particulars appearing in the subsidiary books. The totals of these sheets are then recorded in summary books (separate books being used for sales, purchases, returns, bills, etc.), from which the Adjustment Accounts are afterwards constructed. An example of these summary books is given on page 244.

Contras or Transfers.

It will be found in practice that goods are sometimes bought from, and sold to, the same customer, in which case the point arises as to the method by which these transactions are dealt with when the adjustment accounts are being prepared. Where the customer concerned stipulates that the buying and selling transactions shall be separately treated and not set-off against each other in determining his net liability, no difficulty will arise. But where settlement is effected by deducting one account from the other and the balance only is paid to, or by, the customer, the lesser account must be transferred to the greater, either from the Sales Ledger to the Purchases Ledger, or from the Purchases Ledger to the

SALES BOOK

Date	Name	Details	Led. Fol.	Total	Sales Ledgers			
					A to F	G to L	M to S	T to Z

PURCHASES BOOK

Date	Name	Details	Led. Fol.	Total	Purchases Ledgers			
					A to F	G to L	M to S	T to Z

Dr. CASH RECEIVED BOOK

Date	Name	Led. Fol.	Total	Dis- count	Cash	Bank	Ledgers			
							Town	Country	Foreign	Misc.

CASH PAYMENTS BOOK *Cr.*

Date	Name	Led. Fol.	Total	Dis- count	Cash	Bank	Ledgers			
							Town	Country	Foreign	Misc.

BOUGHT LEDGER SUMMARY BOOK

Date	Subsidiary Book	Ledgers					
		A to H		I to Q		R to Z	
		Debits	Credits	Debits	Credits	Debits	Credits

SALES LEDGER SUMMARY BOOK

Date	Subsidiary Book	Ledgers					
		A to H		I to Q		R to Z	
		Debits	Credits	Debits	Credits	Debits	Credits

Sales Ledgers. These transfers are made by entry in the Journal.

Sectional Balancing.

This term is applied to the balancing of ledgers in a group, and the difference between this method and that of self-balancing ledgers can therefore be well appreciated. The main disadvantage of "group balancing" is that if an error is made in any one group of ledgers, it is necessary to check the whole of the ledgers included in that group before agreement can be reached. Here the value of the self-balancing system is obvious, for in this case, re-checking of entries is confined to that particular ledger in which the error arises. The sectional balancing method is to-day restricted to very few businesses, and is, therefore, of little importance, but, in view of the confusion that very often exists in the mind of the student as to the difference between this and the self-balancing system, a brief note on the distinction has been made.

EXERCISE IX

A. Explain briefly the purpose of Self-balancing Ledgers. (C.R.A.)

B. Briefly explain the principle upon which self-balancing ledgers are written up. (R.S.A.)

C. Describe the advantages to be derived from the adoption of the self-balancing system of posting Ledgers. (R.S.A.)

D. The undermentioned errors were made during the half-year ended 30th June, 19.., by the staff of Messrs. Blank & Co., who keep their Sales Ledgers (A–L and M–Z) on the self-balancing system—

1. The Sales Journal (A–L) was overcast £20.
2. Returns from W. Smith, £3 14s. 6d. were not posted.
3. Cash, £42 10s. 6d. received from A. Sack was posted to the credit of A. Jack.

How would these errors affect the adjustment accounts and Trial Balance? (R.S.A.)

E. From the following particulars prepare the General Ledger Adjustment Account in the Sales Ledger—

		£
1st May.	Balances, debit	1,600
	,, credit	550
31st May.	Bills Receivable	100
	Returns	114
	Cash	6,240
	Bad Debts	37
	Sales	8,007
	Discounts	64
	Contra Accounts in B. L.	105

(I.B.)

F. Give suitable rulings for the Sales Journal of a wholesale business comprising three departments, viz., "Mantles," "Dress Materials," and "Felts." There are two Sales Ledgers in use, viz., "Town" and "Country," and each Ledger is kept upon the self-balancing principle. (L.C.C.)

G. From the following particulars prepare the Bought and Sales Ledgers Adjustment Accounts as they will appear in the General Ledger, showing the total credit Balances in the Bought Ledger, and the total debit Balances in the Sales Ledger.

	Bought Ledger	Sales Ledger
	£	£
Opening Balances—Debit	21	5,450
,, ,, Credit	3,260	130
Purchases	1,749	—
Sales	—	3,320
Returns	120	252
Cash	1,830	3,430
Discounts	32	110
Bills Payable	300	—
,, Receivable	—	890
,, ,, Dishonoured	—	100

Transfer Debit Bought Ledger and Credit Sales Ledger, £66.

Schedules of Balances at the close of the period show that there are Debit Balances in the Bought Ledger, £21, and Credit Balances in the Sales Ledger, £12. (I.B.)

H. Rule a form of Cash Book which would be necessary in a business in which a General Ledger, two Bought Ledgers, and two Sold Ledgers are in use, all these Ledgers being "self-balancing." Explain briefly how you would put into practice the principles of self-balancing ledgers in connection with this Cash Book. (L.C.C.)

I. What is the difference between "self-balancing" and "sectional-balancing"? What are the relative advantages and disadvantages of each method?

J. The following books are in use in a printing business, and are properly kept upon the ordinary double-entry system: Cash Book (bank items only), Petty Cash Book (for all cash payments), Purchases Journal, Sales Journal, two Personal Ledgers ("A" Town Debtors, and "B" Country Debtors), Bought Ledger and Nominal Ledger. You are asked to re-arrange the system of book-keeping so that every ledger may be self-balancing.

(L.C.C.)

K. Where the number of Ledgers employed to record purchases and sales of goods are numerous, it is usual to analyse these by means of "Summary Books." Submit rulings suitable for the Summary Books of the Bought and Sales Ledgers of a business composed of four departments.

L. Give a list of the items which are generally found in the Adjustment Accounts of (*a*) the Bought Ledger, and (*b*) the Sales Ledger. State on which side of the Adjustment Account the various items would appear.

M. John Jones decides to keep a "Total Debtors Account" as a check on the accuracy of his Sales Ledgers. The sales for the year amounted to £25,612, and the amount owing at the commencement of the year was £8,965. Cash received from the debtors totalled £21,450, whilst discounts allowed to customers cost £390. Bills Receivable posted to the accounts of customers were £1,870. Transfer of contra accounts from the debit of the Purchases Ledger to the Sales Ledger was £840, and transfers to the Purchases Ledger from the debit of the Sales Ledger totalled £65. Prepare Total Debtors' Account and state what the balance represents.

CHAPTER X

MISCELLANEOUS ACCOUNTS

OPPORTUNITY will now be taken to discuss, under a general heading, a number of miscellaneous accounts, the importance of which hardly warrants individual treatment. Nevertheless, the book-keeping student must be conversant with the subject in all its phases, and, for this reason, the remarks which follow deserve just as much the attention of the reader as the more advanced or practical work treated in the previous and following chapters. The majority of the accounts now discussed have probably already been dealt with by the student in his Intermediate studies, and the purpose of again introducing them is primarily with a view to refreshing and, where necessary, completing his knowledge. Questions on these accounts have appeared in recent advanced examination papers, so, for this reason, a careful study of the present chapter will repay the examinee.

RECEIPTS AND PAYMENTS ACCOUNTS

The Receipts and Payments Account is one which records, either in detail or in a summarized form, the actual cash receipts and cash payments made during a certain period. It is, to this extent, a copy of the Cash Book, and will include the opening cash balance on the debit side and the closing cash balance on the credit side. Where the items are summarized, the summary is obtained by means of a number of analysis columns ruled on each side of the Cash Book into which the individual details are appropriately extended when entry is made.

The chief disadvantage of this account is that it is possible to create a wrong impression of the financial position. This is due to the fact that income due but not received, and expenses outstanding at the date of the account, are not taken into

consideration. Further, no distinction is made between revenue receipts and payments, and those made on account of capital, neither are the balances of debtors and creditors included. The information derived from the account deals solely with the cash receipts, payments and balances, as will be seen from the following specimen—

RECEIPTS AND PAYMENTS ACCOUNT

Dr. FOR THE YEAR ENDED 31ST MAY, 19.. *Cr.*

		£ s. d.			£ s. d.
	To Balance, 1st June	115 10 –		By Wages of Stewards	450 – –
	,, Subscriptions .	650 5 –		,, Repairs . .	99 5 6
	,, Entrance Fees .	17 2 6		,, Fixtures . .	55 10 6
	,, Concert Proceeds .	81 19 –		,, Hire of Halls, etc.	105 9 2
	,, Refreshments .	6 1 3		,, Printing . .	15 6 5
				,, Postage . .	8 – –
				,, Balance c/d .	137 6 2
		£870 17 9			£870 17 9
	To Balance b/d .	137 6 2			

By comparing the opening and closing balances of cash, one would assume that there has been a profit of £21 16s. 2d.; at least, this is the information disclosed by the above Receipts and Payments Account, but if outstanding expenses amount to £25, a loss has, in fact, been made, though the actual cash balance in hand when the account was prepared shows an increase on that of the previous year.

INCOME AND EXPENDITURE ACCOUNTS

The Income and Expenditure Account constitutes the profit and loss account of a non-trading concern. It is generally prepared by clubs, societies, and other institutions, where service rather than profit is the main consideration, and for individual or personal use, so that the individual himself may, by the compilation of such a statement, judge of his own financial position.

This account includes the whole of the income relating to the period for which it is prepared or for which it is intended to cover, whether the income has been received or not, and

includes also the total expenditure paid and that which is to be paid. In this way, all outstanding items are brought into account, and the position thus revealed can be said to approximate more accurately to the true position than would otherwise be the case if the Receipts and Payments Account were prepared in its stead. The Income and Expenditure Account is drawn up in the same way as that for profit and loss, details of the expenditure appearing on the left-hand or debit side, and of the income on the right-hand or credit side.

An analysis of the cash receipts and payments will be made by means of a number of extra columns in the Cash Book, the totals of which are periodically posted to the Ledger Accounts. The various items outstanding at the date upon which the Income and Expenditure Account is prepared are dealt with in the same manner as that explained in Chapter II, when profit and loss adjustments were discussed. Expenses due but not paid are debited to the respective ledger accounts, and brought down to the succeeding period as credit balances. Conversely, income due but not received is credited to the appropriate ledger accounts and carried down as debit balances.

Where the accounts have been properly prepared, it should be possible to construct a Balance Sheet in the usual way.

EXAMPLE 1. The transactions shown by the summary of the Cash Account for the season —— of the Crack Cricket Club were as follows—

	£	s.	d.
Subscriptions: Playing Members	34	13	–
,, Honorary Members	39	18	–
Profit from Sports Meeting	15	–	–
Cricket Field Rent Receivable	5	–	–
Gate Money	30	6	6
Groundsman's Wages	30	–	–
Umpires' Fees and Playing Expenses	12	10	–
Maintenance and Repairs	25	6	–
League Subscriptions	5	5	–
Printing and Stationery	16	8	–
Postage and Sundries	5	12	6

At the close of the year the following subscriptions had not been paid: (*a*) Playing Members, £4 4s., and (*b*) Honorary Members, £2 2s. The following accounts were also outstanding:

(1) Outfitters' Account, £3 10s.; (2) Joiner's Account, £5 6s., and (3) Stationery Account, £2. No accounts were owing at the commencement of the season, but arrears of subscriptions amounting to £7 7s. were due from playing members, and had been received. Prepare the Club's Income and Expenditure Account.

THE CRACK CRICKET CLUB

INCOME AND EXPENDITURE ACCOUNT

Dr. FOR THE SEASON ENDED .... *Cr.*

	£	s.	d.		£	s.	d.
To Groundsman's Wages	30	–	–	By Subscriptions—Hon'ary Members	42	–	–
,, Umpires' Fees and Playing Exps.	12	10	–	Playing Members	31	10	–
,, Maintenance and Repairs	34	2	–	,, Profit from Sports Meeting	15	–	–
,, League Subscriptions	5	5	–	,, Loan of Field	5	–	–
,, Printing and Stationery	18	8	–	,, Gate Money	30	6	6
,, Postage and Sundries	5	12	6				
,, Balance—profit[1]	17	19	–				
	£123	16	6		£123	16	6

[1] This is often referred to as "Income over Expenditure," or *vice versa* where a loss is made. The "profit" is added to, or the "loss" deducted from, the Capital or Accumulated Fund Account in the Balance Sheet.

The distinction between a Receipts and Payments Account and an Income and Expenditure Account is one not always appreciated by the book-keeping student; indeed, those with practical knowledge oft-times confuse the two accounts. For instance, it is the practice of some persons, unskilled in the art of preparing these accounts, to refer to them as "Balance Sheets" or "Receipts and Expenditure Accounts." Obviously, such accounts cannot be associated with the Balance Sheet, for the latter is a list of balances, not a statement of income and expenditure.

The main difference between the two accounts is in the information disclosed and the results shown. The Receipts and Payments Account gives only the cash transactions and the closing balance of cash. As such, it does not, therefore, give any indication as to the net result of the transactions of the period to which it relates. Comparison between the

opening and closing balances of cash will, of course, disclose how far the receipts have exceeded the payments, or *vice versa*, but this is of little real value if miscellaneous items are outstanding. The Income and Expenditure Account, on the other hand, contains only the income and expenditure relating to the *period under review*, including outstanding items, and the final balance shows to what extent the income has exceeded the expenditure, or *vice versa*. In this way, the net result of the working of the club, concern, or institution is disclosed, and, if there are assets other than cash, it is possible to prepare a balance sheet.

Where it is desired to convert a Receipts and Payments Account into an Income and Expenditure Account, the following rules must be observed—

1. Eliminate all capital receipts and payments.
2. Exclude amounts other than those which relate to the period under review.
3. Bring into account outstanding income and expenditure in respect of the period for which the account is prepared.
4. If necessary, make provision for bad debts, depreciation, etc.

EXAMPLE 2. The following is the Receipts and Payments Account of the Whimouse Social Club for the year ending 31st March, 19..—

Dr. RECEIPTS AND PAYMENTS ACCOUNT *Cr.*

		£	s.	d.			£	s.	d.
	To Balance, 1st April	50	10	6		By Wages—			
	„ Subscriptions	140	–	–		Attendant (*a*)	90	–	–
	„ Donations	15	–	–		Assistant	50	–	–
	„ Proceeds from Games	45	10	3		„ Printing	10	10	–
						„ Postage	4	15	3
						„ Rent of Hall (*b*)	36	–	–
						„ Bal., 31st March	59	15	6
		£251	–	9			£251	–	9

(*a*) Includes £20 in respect of the previous year.
(*b*) Includes £10 in respect of the previous year.

The expenses outstanding at 31st March were Printing, £1 5s., and Rent, 10s., whilst subscriptions due for the current year amounted to £10. In addition to the foregoing, the

following balances appeared in the Club's books as at 31st March—

	£	s.	d.
Capital Account	880	10	6
Premises	750	–	–
Fixtures	60	–	–
Library Books	50	–	–

When preparing the Income and Expenditure Account and Balance Sheet, depreciate Fixtures by £5.

INCOME AND EXPENDITURE ACCOUNT

Dr. FOR THE YEAR ENDING 31ST MARCH *Cr.*

Expenditure	£	s.	d.	*Income*	£	s.	d.
To Wages—				By Subscriptions .	150	–	–
Attendant .	70	–	–	,, Donations . .	15	–	–
Assistant . .	50	–	–	,, Proceeds from Games . .	45	10	3
,, Printing . .	11	15	–				
,, Postage . .	4	15	3				
,, Rent of Hall .	26	10	–				
,, Depreciation .	5	–	–				
,, Balance (being excess of Income over Expenditure) . .	42	10	–				
	£210	10	3		£210	10	3

THE WHIMOUSE SOCIAL CLUB

BALANCE SHEET AS AT 31ST MARCH, 19..

Liabilities				£	s.	d.	*Assets*	£	s.	d.
Creditors . . .				1	15	–	Cash	59	15	6
Capital Account—							Debtors	10	–	–
Balance, 1st April	£880	10	6				Fixtures, *less* Depreciation	55	–	–
Add Excess of Income over Expenditure .	42	10	–				Library Books . .	50	–	–
				923	–	6	Premises . . .	750	–	–
				£924	15	6		£924	15	6

ROYALTY ACCOUNTS

The term "royalty," viewed in the commercial sense, is meant to denote the monetary payment made for the right to exercise certain privileges or monopolies. Thus, the lessee of a coal mine may pay to the lessor or landlord a royalty per ton on the coal he raises; a manufacturer may pay to the patentee a royalty for the use of certain patent rights per article produced or sold.

Dealing for the purpose of illustration with the leasing of mines, the royalty to the landlord will be in the nature of a charge of so much per ton raised. But, in view of the fact that the early operations of a mining company are confined chiefly to the sinking of the shaft and other constructions preliminary to the raising of coal, it is usual for the landlord to receive a fixed rent for the first few years, irrespective of the output of the mine, which merges into a royalty as soon as the actual mining operations become remunerative. This rent is termed a *minimum* or *dead rent*, and, by its payment the landlord is assured of a certain regular income. It is also customary for the terms of this arrangement to stipulate that the amount by which the rent exceeds the royalty (based on output) called "*shortworkings*," shall be recouped by the lessee over a fixed period of years.

The entries to be made in the books of the lessee are summarized below—

(*a*) *When the Rent is greater than the Royalty earned*—

1. Debit Royalties Account and credit Minimum Rent Account with the royalty based on actual output.

2. Debit Minimum Rent Account and credit Landlord Account with the amount of minimum rent payable.

3. Debit Shortworkings Account and credit (and close) Minimum Rent Account with the balance by which the minimum rent exceeds the royalty earned.

4. Debit Landlord Account and credit Cash Book when minimum rent is paid.

(*b*) *When the Royalty earned exceeds the Minimum Rent and shortworkings may be recouped*—

1. Debit Royalties Account and credit Landlord Account with the royalty based on actual output.

2. Debit Landlord Account and credit Shortworkings Account with the excess of royalty earned over the minimum rent.

3. Debit Landlord Account and credit Cash Book when minimum rent is paid.

The Royalties Account will be closed each year by transfer to the Trading Account. Where there exists a balance in the Shortworkings Account after the period allowed for recoupment has expired, this is transferred to the Profit and Loss Account (see example below).

EXAMPLE 3. A mining company leased land from Mr. J. Jones at a minimum rent of £1,000 per annum, and a royalty of 6d. a ton on all coal raised, shortworkings to be recouped during the first four years. The coal raised during these years was as follows: First year, 27,000 tons; second year, 30,000 tons; third year, 33,000 tons; fourth year, 60,000 tons. Give the necessary Journal entries and Ledger Accounts to record the transactions of the company for the four years referred to.

JOURNAL

Year			*Dr.* £	*Cr.* £
1	Royalties Account . . . *Dr.* To Minimum Rent Account . . Being 6d. per ton on 27,000 tons raised.		675	675
	Minimum Rent Account . . *Dr.* To Landlord Account . . . Being rent payable.		1,000	1,000
	Shortworkings Account . . *Dr.* To Minimum Rent Account . . Being transfer of balance.		325	325
2	Royalties Account . . . *Dr.* To Minimum Rent Account . . Being 6d. per ton on 30,000 tons raised.		750	750
	Minimum Rent Account . . *Dr.* To Landlord Account . . . Being rent payable.		1,000	1,000
	Shortworkings Account . . *Dr.* To Minimum Rent Account . . Being transfer of balance.		250	250

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Year		Dr.	Cr.
		£	£
3	Royalties Account . . . Dr.	825	
	To Minimum Rent Account . .		825
	Being 6d. per ton on 33,000 tons raised.		
	Minimum Rent Account . . Dr.	1,000	
	To Landlord Account . . .		1,000
	Being rent payable.		
	Shortworkings Account . . Dr.	175	
	To Minimum Rent Account . .		175
	Being transfer of balance.		
4	Royalties Account . . . Dr.	1,500	
	To Landlord Account . .		1,500
	Being 6d. per ton on 60,000 tons raised.		
	Landlord Account . . . Dr.	500	
	To Shortworkings Account . .		500
	Being amount recouped out of excess of royalties.		
	Profit and Loss Account . . Dr.	250	
	To Shortworkings Account .		250
	Being balance irrecoverable. . .		

There is an alternative method of recording the journal entries in those years in which the minimum rent exceeds the royalty earned. Whilst no actual change is made in the nature of these entries, the alternative method requires only two, instead of three, entries each year, viz.—

Year			
		£	£
1	Royalties Account . . . Dr.	675	
	Shortworkings Account . . Dr.	325	
	To Minimum Rent Account . .		1,000
	Minimum Rent Account . . Dr.	1,000	
	To Landlord Account . . .		1,000

Dr. LANDLORD ACCOUNT *Cr.*

Year			Year		
1	To Cash	£1,000	1	By Minimum Rent A/c .	£1,000
2	,, ,, ...	£1,000	2	,, ,, ,, ,, .	£1,000
3	,, ...	£1,000	3	,, ,, ,, ,, .	£1,000
	,, ,, . . .	1,000	4	,, Royalties A/c . .	1,500
	,, Shortworkings A/c .	500			
		£1,500			£1,500

Dr. MINIMUM RENT ACCOUNT *Cr.*

Year		£	Year		£
1	To Landlord Account .	1,000	1	By Royalties Account .	675
				,, Shortworkings A/c .	325
		£1,000			£1,000
2	,, ,, ,, .	1,000	2	,, Royalties Account .	750
				,, Shortworkings A/c .	250
		£1,000			£1,000
3	,, ,, ,, .	1,000	3	,, Royalties Account .	825
				,, Shortworkings A/c .	175
		£1,000			£1,000

Dr. ROYALTIES ACCOUNT *Cr.*

Year			Year		
1	To Minimum Rent A/c .	£675	1	By Trading Account .	£675
2	,, ,, ,, ,, .	£750	2	,, ,, ,, .	£750
3	,, ,, ,, ,, .	£825	3	,, ,, ,, .	£825
4	,, Landlord Account .	£1,500	4	,, ,, ,, .	£1,500

Dr. SHORTWORKINGS ACCOUNT *Cr.*

Year		£	Year		£
1	To Minimum Rent A/c .	325	4	By Landlord Account .	500
2	,, ,, ,, ,, .	250		,, Profit and Loss A/c .	250
3	,, ,, ,, ,, .	175			
		£750			£750

Dr. CASH BOOK *Cr.*

Year		£	Year		
			1	By Landlord Account .	£1,000
			2	,, ,, ,, .	£1,000
			3	,, ,, ,, .	£1,000
			4	,, ,, ,, .	£1,000

HIRE-PURCHASE ACCOUNTS

Goods sold under the hire-purchase system mainly differ from ordinary sales for two reasons: (1) the purchase price or consideration is spread over a period of time which extends beyond that customarily allowed, and (2) the ownership in

the goods remains vested in the seller until the *final* instalment is paid. The failure on the part of the purchaser to pay the instalments on the due dates will entitle the seller, unless a contrary provision is expressed in the sale agreement, to resume possession of the goods, with or without compensation for that part of the purchase price already paid by the hire-purchaser.

Having regard to the protracted nature of the payments, it is obvious that, from the seller's point of view, each instalment he receives includes a charge in the nature of interest. This interest, which must not be confused with that received in respect of bank deposits or investments, is entered in a special account. A separate Day Book will be kept to record hire-purchase transactions, the totals of which will be periodically credited to the Hire-Purchase Sales Account, and the individual items debited to the hire-purchasers' personal accounts in the ledger. The latter accounts are debited from time to time with interest, the credit entry being made in the Hire-Purchase Interest Account. The balance of this Interest Account is subsequently transferred to the credit of the Profit and Loss Account. When an instalment is received, the purchaser's account in the Ledger is credited and the Cash Book debited with the amount of the instalment.

EXAMPLE 4. A manufacturing company purchases a machine from the X Y Z Machinery Co., on the hire-purchase system spread over a period of five years, payable by annual instalments of £100. Interest is charged at 5 per cent on yearly balances which, when deducted from the total instalments, gives the cash value of the machine, which, in this case, is £432 19s. Show the accounts in the books of the seller.

Dr. HIRE-PURCHASE INTEREST ACCOUNT *Cr.*

Year 1	To Profit & Loss A/c		£21 12 11	Year 1	By Manufacturing Co.		£21 12 11
2	,, ,, ,, ,,		£17 14 7	2	,, ,, ,,		£17 14 7
3	,, ,, ,, ,,		£13 12 4	3	,, ,, ,,		£13 12 4
4	,, ,, ,, ,,		£9 5 11	4	,, ,, ,,		£9 5 11
5	,, ,, ,, ,,		£4 15 3	5	,, ,, ,,		£4 15 3

Dr. A MANUFACTURING COMPANY *Cr.*

Year		£ s. d.	Year		£ s. d.
1	To Hire - Purchase Account . .	432 19 –	1	By Cash . .	100 – –
	,, Interest . .	21 12 11		,, Balance c/d .	354 11 11
		£454 11 11			£454 11 11
2	,, Balance b/d .	354 11 11	2	,, Cash . . .	100 – –
	,, Interest .	17 14 7		,, Balance c/d .	272 6 6
		£372 6 6			£372 6 6
3	,, Balance b/d .	272 6 6	3	,, Cash . . .	100 – –
	,, Interest . .	13 12 4		,, Balance c/d .	185 18 10
		£285 18 10			£285 18 10
4	,, Balance b/d .	185 18 10	4	,, Cash . . .	100 – –
	,, Interest . .	9 5 11		,, Balance c/d .	95 4 9
		£195 4 9			£195 4 9
	,, Balance b/d .	95 4 9	5	,, Cash . . .	100 – –
	,, Interest . .	4 15 3			
		£100 – –			£100 – –

NOTE. Interest calculations have been worked to the nearest penny.

An illustration of the entries to be recorded by the purchaser will be simplified if the question of depreciation is, for the moment, disregarded. Special accounts should be opened in the purchaser's books for (1) the "principal" part of each instalment paid, (2) the "interest" or "hire" portion of each instalment paid, and (3) the person or concern from whom the goods are purchased. The actual cash value of the goods acquired will be ascertained by deducting from the purchase price, the interest calculated over the whole period during which payment is to be made. As each instalment becomes due, the Instalment and Interest (or Hire, as it is sometimes called) Accounts will be debited with their proper proportions, and the Seller's Account credited with the whole instalment. When cash is remitted the Cash Book is credited and the Seller's Account debited with the amount paid. The Interest (or Hire) Account is periodically closed by transferring its balance to the debit side of the Profit and Loss Account. After the final payment has been made, the Instalment Account will show the approximate cash value of the goods acquired, and a special account to represent the goods or

asset will then be opened, to which this value is subsequently transferred. The balance of the asset account will, of course, appear on the right-hand side of the Balance Sheet.

EXAMPLE 5. A manufacturing company purchases a machine from the X Y Z Machinery Co. on the hire-purchase system spread over a period of five years, payable by annual instalments of £100. Interest is charged at 5 per cent per annum on yearly balances which, when deducted from the total instalments, gives the cash value of the machine at £432 19s. Disregarding depreciation, show the accounts in the books of the purchaser.

Dr. INSTALMENTS ON MACHINE ACCOUNT *Cr.*

Year		£ s. d.	Year		£ s. d
1	To X Y Z Co. . .	78 7 1	1	By Balance c/d .	78 7 1
2	,, Balance b/d .	78 7 1			
	,, X Y Z Co. . .	82 5 5	2	,, Balance c/d	160 12 6
		£160 12 6			£160 12 6
3	,, Balance b/d .	160 12 6			
	,, X Y Z Co. .	86 7 8	3	,, Balance c/d	247 – 2
		£247 – 2			£247 – 2
4	, Balance b/d .	247 – 2			
	,, X Y Z Co. . .	90 14 1	4	,, Balance c/d .	337 14 3
		£337 14 3			£337 14 3
5	,, Balance b/d .	337 14 3			
	,, X Y Z Co. . .	95 4 9	5	,, Machinery A/c .	432 19 –
		£432 19 –			£432 19 –

Dr. MACHINERY HIRE ACCOUNT *Cr.*

Year			Year		
1	To X Y Z Co. . .	£21 12 11	1	By P. & L. A/c .	£21 12 11
2	,, ,, ,, . .	£17 14 7	2	,, ,, ,, .	£17 14 7
3	,, ,, ,, . .	£13 12 4	3	,, ,, ,, .	£13 12 4
4	,, ,, ,, . .	£9 5 11	4	,, ,, ,, .	£9 5 11
5	,, ,, ,, . .	£4 15 3	5	,, ,, ,, .	£4 15 3

NOTE. The apportionment of the instalments between capital and revenue has been worked to the nearest penny.

Dr. X Y Z MACHINERY COMPANY *Cr.*

Year		£ s. d.	Year		£ s. d.
1	To Cash . . .	100 – –	1	By Instalment A/c .	78 7 1
				,, Hire Account .	21 12 11
		£100 – –			£100 – –
2	,, Cash . . .	100 – –	2	,, Instalment A/c .	82 5 5
				,, Hire Account .	17 14 7
		£100 – –			£100 – –
3	,, Cash . . .	100 – –	3	,, Instalment A/c .	86 7 8
				,, Hire Account .	13 12 4
		£100 – –			£100 – –
4	,, Cash . . .	100 – –	4	,, Instalment A/c .	90 14 1
				,, Hire Account .	9 5 11
		£100 – –			£100 – –
5	,, Cash . . .	100 – –	5	,, Instalment A/c .	95 4 9
				,, Hire Account .	4 15 3
		£100 – –			£100 – –

Dr. MACHINERY ACCOUNT *Cr.*

Year		£ s. d.	Year		£ s. d.
6	To Transfer from Instalment A/c .	432 19 –			

Before proceeding, it would, perhaps, be advisable to deal with two important points which arise whilst the instalments are being paid. The first deals with the manner in which the balance of the Instalment Account should appear in the final accounts. It must be observed that the hire-purchaser has acquired an asset, the payment for which is extended over a period of years. Theoretically, the balance of the Instalment Account should be included with the other assets, but, as this would not give any indication as to the amount outstanding in respect of its payment at the date of the accounts, it would seem to be the best course to show the cash value of the goods or asset acquired, less the liability in respect thereof, the net amount being extended to the balance sheet

totals. Information is then given as to the total instalments paid and the amount still to be paid.

The second point is a controversial one, and deals with the depreciation of the goods acquired by means of an hire-purchase agreement. That depreciation should not be taken into account is contended by many authorities on the ground that it is incorrect to write down the value of goods, the property in which is possessed by some other person. Although there may be an element of reason in this argument, sight must not be lost of the fact that the goods will ultimately become the property of the hire-purchaser. These goods (as in the case of plant and machinery) will presumably be in use whilst the instalments are being paid, and, as a result, depreciation through wear and tear is almost bound to arise. This being so, is it prudent to ignore this loss on the ground that the hire-purchaser does not own the goods? What is the result if depreciation is disregarded? At the end of the payments, the asset will appear in the purchaser's books at the value stated in the hire-purchase agreement; depreciation which has taken place whilst the payments have been made must then be taken into account, or the asset must appear in the books at a fictitious figure. Assuming the former course is adopted, the loss in value which has arisen during the years in which the acquisition has been taking place will be charged to the profit of the first year in which the asset really becomes the property of the hire-purchaser, with the result that the profit earned during that year is either seriously diminished or is turned into a loss; a loss which becomes an unfair burden on the trading of subsequent years.

The main object of providing for depreciation is to ensure that assets will appear in the books as near as possible to their true value. Where the acquisition of an asset is gradual, as in the case of hire-purchase, it is held by many accountants that provision for loss through wear and tear is just as necessary as if the asset had been purchased outright for cash. Referring again to the argument of those who state that depreciation should not be taken into account, this seems to apply more to cases where the goods acquired are in the

nature of a fixed asset, the true value of which is measured by its revenue-earning capacity, and not necessarily by market or outside values. Even in this case, however, there is certain to be some loss in value as a result of the employment to which the asset is put, for which provision should be calculated and made.

INSTALMENT-PAYMENT PURCHASES

Students are apt to confuse these purchases with those contracted under the hire-purchase system. The chief difference lies in the fact that in the case of instalment-payment purchases, the property in the goods sold passes to the purchaser on payment of the first instalment. Default in payment does not, therefore, entitle the seller to resume possession; his remedy is an action for loss, taken to recover the balance of instalments outstanding.

The *seller* must apportion the sale price between the Sales Account and an Interest Suspense Account, the total sale price being debited to the purchaser's account in the Ledger. The Cash Book is debited and the purchaser's account credited with each instalment as this is received. The portion of interest accruing each year is calculated and written off annually by crediting the Profit and Loss Account and debiting the Interest Suspense Account. In this way the amount of interest appearing in the latter account is gradually diminished and finally eliminated by means of these transfers, each year being credited with its proper proportion by crediting the Profit and Loss Account as described above.

Entries in the *buyer's* books will be somewhat similar to those made in the hire-purchaser's books already discussed. The cash value of the goods bought is debited to an asset account and credited to the vendor's account. Interest at the rate stipulated in the sale agreement is charged on the balances outstanding and debited to an Interest Account, the credit entry appearing in the vendor's account. When an instalment is paid, the vendor's account is debited and the Cash Book credited with the value of the instalment.

PERCENTAGE PROFIT AND LOSS

The value of analysis as applied to final accounts has, to some extent, been illustrated in the chapters on Departmental and Branch Accounts, where the main purpose in view was to calculate the trading activities of each section of the firm. But where it is desired to obtain a comparison of the true relative importance of the various items affecting profit and loss, apart from that section of the business in which they have been incurred, the use of percentages has been found to be associated with many advantages. Accounts prepared in this way disclose the ratio which the costs of production and administration bear to the turnover and output. Thus, not only is the trader in a position to prepare more accurately estimates and tenders for future work, but the information furnished each year enables him to ascertain any substantial increase or decrease in productive costs as compared with the turnover.

The Trading and Profit and Loss Account is compiled in the ordinary manner, but on each side an extra column will be included for the percentages. The most common method of dealing with these percentages is that in which the total sales are used as a basis on which the percentage of all other items is taken, by means of the following formula—

$$\frac{\text{Item (expense, gain, income, etc.)} \times 100}{\text{total net sales}}$$

From the example which follows it will be observed that the opening and closing stocks are omitted. For the sake of arriving at the percentages, it is essential that both the sales figure and the total of the Trading Account appear at "100," which would not be possible if the final stock was included. Instead, the term "materials consumed" is introduced, the value of this being calculated by adding to the opening stock the purchases, and from the total of these deducting the closing stock.

EXAMPLE 6. From the undermentioned items, which have been extracted from the Trial Balance of a manufacturing

company, compile Percentage Trading and Profit and Loss Account showing the percentage which each item bears to the turnover.

	£
Purchases	41,000
Sales	60,000
Salaries	2,100
Rent	750
Insurance	210
Carriage, Inwards	450
Carriage, Outwards	1,122
Stock (opening)	4,500
Wages	2,700
Rates	402
Lighting	150
Discount	72
Factory Heating and Lighting	300
Repairs	138
General Expenses	120
Bad Debts	324
Stock (closing)	3,500

	£
Opening Stock	4,500
Add Purchases	41,000
	45,500
Less Closing Stock	3,500
Materials Consumed	£42,000

The solution to this example appears on page 266.

Percentage Trading and Profit and Loss Accounts also enable a comparison of results to be made from year to year. Increases in the various expenses and charges are instantly disclosed and, where necessary, economies may be instituted in those circumstances in which the turnover has not shown a corresponding increase.

MANUFACTURING ACCOUNTS

The manufacturer who produces saleable articles from raw materials, prepares his Trading Account in a different way from that adopted by the trader who purchases goods in the same, or practically the same, state as that in which he sells

TRADING AND PROFIT AND LOSS ACCOUNT

Dr. FOR THE YEAR ENDED ....19.. Cr.

	Per Cent	£		Per Cent	£
To Materials	70·00	42,000	By Sales	100·00	60,000
,, Wages	4·5	2,700			
,, Carriage	·75	450			
,, Heating and Lighting	·5	300			
,, Gross Profit c/d	24·25	14,550			
	100·00	£60,000		100·00	£60,000
To Salaries	3·5	2,100	By Gross Profit b/d	24·25	14,550
,, Rent	1·25	750			
,, Insurance	·35	210			
,, Carriage	1·87	1,122			
,, Rates	·67	402			
,, Lighting	·25	150			
,, Discount	·12	72			
,, Repairs	·23	138			
,, General Expenses	·2	120			
,, Bad Debts	·54	324			
,, Net Profit	15·27	9,162			
	24·25	£14,550		24·25	£14,550

them. It is usual to keep the manufacturing and selling sections quite distinct, and, as a result, the transactions of each can be fairly accurately calculated. The Manufacturing Account, which is prepared to ascertain the prime cost of each article, deals chiefly with the costs of raw materials and the *direct* charges incurred during the process of converting these materials into marketable produce. The cost of the raw materials, carriage thereon, and direct labour charges is, therefore, termed "prime cost." All other expenses consequent upon or incidental to production, administration, and distribution are merged under what is known as "oncost." This is divided into two parts, viz.—

1. **Factory Oncost**, which includes factory rent, rates, power, fuel, lighting and heating; machinery repairs and depreciation; wages of foremen, time-keepers, storesmen, etc. (These items appear in the second part of the Manufacturing Account.)

2. **General Oncost**, comprising all charges incurred in selling and distributing the goods produced for sale, together with the administrative and office costs, all of which normally appear in the Profit and Loss Account.

Partial allocation between productive and administrative costs is made when the Trading and Profit and Loss Account is prepared, but this is carried on to a much greater degree in the Manufacturing Account. The latter should be divided into two sections. The first, headed "Prime Cost," deals only with the cost of raw materials and direct productive charges, being debited in addition to these, with the opening stock of raw materials and partly manufactured goods, and credited with the closing stocks of these last two items. The balance of this is transferred to the second part headed "Cost of Production," which is debited with the factory oncost, the difference between the totals of the two sides representing the cost of production, which is subsequently transferred to the Trading Account.

A specimen Manufacturing, Trading and Profit and Loss Account is given on page 268. The reader is advised to compare this with the usual form of Trading Account, the chief differences being noted.

MANUFACTURING ACCOUNT

FOR THE YEAR ENDED..............19..

Dr. *Cr.*

(a) *Prime Cost*

Dr.	£	s.	d.	Cr.	£	s.	d.
To Stock (opening)—				By Stock (closing)—			
Raw Materials	5,001	10	–	Raw Materials	4,875	10	3
Partly Manufactured Goods	4,800	–	–	Partly Manufactured Goods	8,000	15	3
,, Purchase of Raw Material	35,750	15	–	,, Balance (transferred to Cost of Production Account)	53,742	2	–
,, Carriage	1,055	7	3				
,, Productive Wages	20,010	15	3				
	£66,618	7	6		£66,618	7	6

(b) *Cost of Production*

Dr.	£	s.	d.	Cr.	£	s	d.
To Balance (from Prime Cost Account)	53,742	2	–	By Proportion of Factory Oncost on Partly Manufactured Goods—£8,000 15s. 3d.—c/f	821	18	9
,, Proportion of Factory Oncost on Partly Manufactured Goods—£4,800—b/f	486	10	1	,, Balance (transferred to Trading Account)	60,822	13	4
,, Factory Oncost—							
Wages and Salaries	2,200	10	–				
Fuel, Lighting, etc.	1,652	5	6				
Rent, Rates, and Taxes	1,520	–	–				
Insurance	180	10	6				
Repairs, etc.	1,862	14	–				
	£61,644	12	1		£61,644	12	1

TRADING ACCOUNT

Dr.	£	s.	d.	Cr.	£	s.	d.
To Balance (from Cost of Production Account)	60,822	13	4	By Sales	130,312	10	8
,, Stocks (opening) of Manufactured Goods	12,387	–	–	,, Stocks (closing) of Manufactured Goods	15,496	17	–
,, Sundry Charges	1,196	14	4				
,, Gross Profit (transferred to Profit and Loss Account)	71,403	–	–				
	£145,809	7	8		£145,809	7	8

Although the illustration will convey to the student the general method of compiling the Manufacturing Account, there is, perhaps, one point to which attention should be specially drawn. This is the item of "*proportion of factory oncost*" appearing on both the debit and credit sides of the "Cost of Production" section of the Account. The reason for the appearance of this item is that if the ultimate profit is to be correct, it is necessary to carry forward the oncost charges on the partly manufactured goods to the period in which these goods are actually completed for sale. This is done by means of a percentage based on the value of the partly manufactured goods in stock at the close of the trading year. Accordingly, the oncost on the balance of these goods is carried forward to the succeeding financial year, and appears as a debit item for that year. It is for this reason that both items are included, the debit entry referring to the proportion of factory oncost on the stock of partly manufactured goods brought forward from the previous year, and the credit entry referring to the factory oncost on the stock of these goods carried forward to the succeeding financial year.

SINGLE ENTRY

The reader who has been through an Intermediate course will recognize single entry as the method applied to any system of book-keeping which is not carried to a sufficient finality to afford a complete double entry of all the transactions dealt with. The remarks which follow, therefore, mainly relate to the rules for converting books from single to double entry, and to the method of ascertaining the profit, by means of statements, where books are kept otherwise than on the double-entry principle.

The chief disadvantage of the single-entry method is that the records of the transactions, being only partial, are incomplete. As a result of this, a trial balance cannot be prepared which will vouch for the arithmetical accuracy of the book-keeping entries and, consequently, the final accounts, if they can be referred to as such, are unreliable. Further, risk of

fraud and inaccuracies is greater where books cannot be made to balance properly, while the information relating to assets, liabilities, expenses, income, etc., is far from satisfactory.

Single entry, in its simplest form, provides only for the keeping of a Cash Book and a personal ledger for the creditors and debtors. Purchases are recorded by direct entry from the invoices to the creditors' accounts, a credit entry being made in the Cash Book when payment is made in respect of such purchases. Sales are treated in a similar manner; the debtors' accounts being debited with the goods at the time of sale, and credited with the cash when this is received, the corresponding debit entry appearing in the Cash Book. For cash sales, a special book may be kept, the totals of this being periodically transferred to the Cash Book.

From this cursory outline it is clear that information is limited. As has been previously mentioned, profit is ascertained by means of statements prepared at various intervals, the difference between the opening and closing capitals being taken as an approximation of the profit (or loss). For the trader in a very small way of business, this may seem sufficient, but where transactions are many and varied, a much more elaborate scheme is obviously essential. That the method of profit-finding by means of Statements of Affairs is far from satisfactory is further emphasized by the example given below.

EXAMPLE 7. P. Herman and C. Chapney are equal partners in a business, the books being kept on the single entry method. The position of affairs at 1st January, was as follows—

Liabilities	£	*Assets*	£
Creditors	1,500	Cash	80
Bills Payable	550	Bank	1,390
Capital Accounts—		Bills Receivable	450
P. Herman	3,500	Debtors	1,250
C. Chapney	3,500	Stock	2,100
		Machinery	3,500
		Fixtures	280

The following was the state of affairs at 31st December: Cash, £58; Bank, £2,000; Bills Receivable, £490; Debtors,

£1,975; Stock, £2,800; Creditors, £1,651; Bills Payable, £496. The Machinery and Fixtures' balances as stated above. The partners have drawn £400 each and were entitled to interest on capital at 5 per cent per annum. Depreciation on Machinery and Fixtures was agreed at 10 per cent and 5 per cent respectively. Draw up final accounts.

STATEMENT OF PROFIT AND LOSS
31ST DECEMBER, 19..

	£	£		£	£
Creditors		1,651	Machinery	3,500	
Bills Payable		496	*Less* Depreciation	350	
Balance (Capital, 31st December) c/d		8,600			3,150
			Fixtures	280	
			Less Depreciation	14	
					266
			Stock		2,800
			Debtors		1,975
			Bills Receivable		490
			Cash		58
			Bank		2,008
		£10,747			£10,747
Capital, 1st January		7,000	Capital, 31st December, b/d		8,600
Interest—			Drawings—		
P. Herman	175		P. Herman	400	
C. Chapney	175		C. Chapney	400	
		350			800
Balance (net profit)—					
P. Herman	1,025				
C. Chapney	1,025				
		2,050			
		£9,400			£9,400

STATEMENT OF AFFAIRS
OF P. HERMAN AND C. CHAPNEY AS AT 31ST DECEMBER, 19..

Liabilities	£	£	*Assets*	£	£
Creditors		1,651	Cash		58
Bills Payable		496	Bank		2,008
Capital Accounts—			Debtors		1,975
P. Herman	3,500		Bills Receivable		490
Add Interest	175		Stock		2,800
Profit	1,025		Machinery	3,500	
			Less Depreciation	350	
	4,700				3,150
Less Drawings	400		Fixtures	280	
		4,300	*Less* Depreciation	14	
C. Chapney	3,500				266
Add Interest	175				
Profit	1,025				
	4,700				
Less Drawings	400				
		4,300			
		£10,747			£10,747

The preparation of the Statement of Affairs is the first step taken towards the conversion of books from single to double entry. When this has been finally agreed it will be necessary to—

1. Open separate accounts for all balances appearing in the Statement (except Cash, Debtors and Creditors, particulars of which already appear in the Cash Book and Personal Ledger).

2. Open nominal accounts and transfer to these all impersonal entries appearing in the Cash Book.

3. Prepare a schedule, with analysis columns, of all purchases, sales and returns which are shown in the Personal Ledger; transfer these to the Purchases, Sales and Returns Accounts.

4. Analyse and post the bill transactions to the Bills Receivable and the Bills Payable Accounts.

5. The excess of the total assets over the total liabilities, as shown by the Statement of Affairs, will then be the initial capital.

When effect has been given to these rules, the whole of the transactions of the business will have been recorded on the double-entry basis. It will then be possible to compile a trial balance which should prove the accuracy of the book-keeping entries. Final accounts will be constructed from this Trial Balance in the usual way.

INVESTMENT ACCOUNTS

In cases where the number of investments held by a concern is large, it becomes necessary to keep a separate record for each, giving particulars of the nominal and cost values, and the income received from time to time. For this purpose an account is ruled with three columns on each side, headed (1) Nominal Value; (2) Income, and (3) Capital. A separate account is opened for each investment giving the name and nature of the investment, the return it yields, and the due

....(Name of Investment)

Dr. Interest payable..................................and.. *Cr.*

Date	Particulars	Fol.	Nominal Value	Income	Capital	Date	Particulars	Fol.	Nominal Value	Income	Capital

dates on which the income becomes payable. A specimen of an Investment Account appears on page 273.

At the time of purchase, the nominal value of the investment is entered in the "Nominal" column, the actual cost being recorded in the "Capital" column. The Cash Book is debited and the Investment Account (Income column) credited with the dividend or interest when this is received. Dividends due at balancing time, but not received, are entered in the Income column and carried down as a balance in the same way as outstanding items are passed through the nominal accounts. At the close of the financial year, a schedule of all investments will be prepared giving in total the nominal value, the cost price, and the income received. The last-named figure is posted to an Interest or Dividends Account, and is subsequently transferred to the Profit and Loss Account.

Investments should appear in the Balance Sheet at cost, market quotations being ignored except where a substantial fall tends to be a permanent one. Depreciation should then be made either in the form of a separate fund or by marking down the value of the asset in the Balance Sheet.

The purchase of an investment *cum. div.* simply denotes that the dividend accrued at the time of purchase belongs to the buyer or, in other words, that the purchase price includes the dividend accrued. A portion of the purchase price should, therefore, be debited to the Income column so that this will be set-off against the full dividend when it is subsequently received. A similar adjustment is made when an investment is disposed of *cum. div.* That proportion of the dividend accrued at the time of sale is calculated and entered in the Income column on the credit side of the Investment Account, the balance of the money received being recorded in the Capital column. Any profit or loss arising from the sale of an investment is posted to an account appropriately styled, the final balance of this being transferred to the Profit and Loss Account. This only applies to cases where the whole of the investment is disposed of. When only a portion of the holding is sold, any profit or loss is carried forward until the balance of the investment is finally sold.

EXERCISE X

A. What is the chief difference between a "Receipts and Payments Account" and an "Income and Expenditure Account"? In what undertakings are these forms of accounts respectively made use of? (R.S.A.)

B. Explain the difference between a "Receipts and Payments Account" and an "Income and Expenditure Account." For what types of enterprises would you consider such statements suitable? Illustrate your answer by drafting a simple "Receipts and Payments Account," and then preparing an "Income and Expenditure Account" as it would be prepared by the same concern for the same period. (C.A.A.)

C. Is there any difference between a Receipts and Payments Account and an Income and Expenditure Account? The following particulars relate to the Chilworth Literary Society for the year ended 31st December: Subscriptions received, £110; Interest received on Investment, £38; net proceeds from Lectures and Concerts, £232; Rent paid for use of Hall, £21; Petty Cash Payments, £10; Advertising paid, £21; Printing Expenses paid, £12 10s. The Society holds ten 4 per cent debentures of £100 each in the Universal Library, Ltd. As on 31st December, the Society owed £8 for Rent of Hall and £9 10s. for Printing. Prepare the Society's Annual Statements of Account for the year ended 31st December. (L.C.C.)

D. In connection with the coal mining industry, explain the following terms: Minimum Rent, Royalty, Shortworkings, and describe any special book-keeping records which may be necessary in connection with the explanations you submit. (R.S.A.)

E. Explain briefly, by means of *pro forma* examples, how Royalties and Shortworkings, arising out of a mining lease, are dealt with in the books of the lessee of a colliery. (R.S.A.)

F. A Colliery Company acquired a lease of a colliery for 50 years at a royalty of 1s. per ton with a minimum yearly rent of £1,000, with power to recoup shortworkings. The tons raised during the first four years were as follows—

	Tons
1st year . . .	11,000
2nd year . . .	17,000
3rd year . . .	26,000
4th year . . .	30,000

Prepare the accounts showing the charges to Profit and Loss Account and the amount due to the landlords at the end of each year, assuming that such payments were paid fourteen days after the close of each year. (C.A.A.)

G. The Greystone Quarries are taken on the basis of a royalty of 6d. per ton raised, subject to a minimum rent of £500 per

annum with the right to recoup shortworkings. The output in tons was—

	Tons
1st year . . .	5,000
2nd year . . .	15,000
3rd year . . .	25,000
4th year . . .	50,000

Show the Ledger accounts required to record the above. (I.B.)

H. The X Y Z Colliery Co. leased a colliery upon a minimum rent of £300, merging into a royalty of 6d. per ton with power to recoup any shortworkings over the first three years of the lease. The annual output of the colliery for the first three years was as follows: first year, 6,000 tons; second year, 13,000 tons; third year, 15,000 tons. You are required to (*a*) define "minimum rent," "royalty," "shortworkings," and (*b*) enter into the necessary ledger accounts the transactions referred to above for the first three years.

I. State briefly the salient features of a sale under a hire-purchase agreement from a book-keeper's point of view. Describe the divergence (if any) in the treatment of such sales in the hire-seller's books as compared with that employed in the case of ordinary credit sales. (R.S.A.)

J. Give a brief outline of the usual method of recording Hire-Purchase Account transactions in a buyer's books. (C.R.A.)

K. On 1st January, the Rambler Motor Co., Ltd., sold a motor-car on hire-purchase to R. D. at a cash sale price of £1,000, payable by five yearly instalments of £230 19s. 6d., the first instalment being payable on the 31st December following, and interest being taken at 5 per cent. Submit the accounts in the Company's Ledger affected by the above transaction as they would appear at the end of two years following date of sale. (R.S.A.)

L. What is the object of preparing Percentage Trading and Profit and Loss Accounts? Describe the advantages gained when such an account is prepared.

M. A business has a turnover as follows—

1st year . . .	£5,000
2nd year . . .	£6,000
3rd year . . .	£7,000

The gross and net profits have been as follows—

Gross Profit—	
1st year . . .	£1,000
2nd year . . .	£900
3rd year . . .	£875
Net Profit—	
1st year . . .	£500
2nd year . . .	£420
3rd year . . .	£455

Prepare a statement in tabular form showing the percentages for each year for Gross Profit, Overheads, and Net Profit on turnover. (I.B.)

N. K. Kempthorne makes regularly a gross profit of 20 per cent on his sales. He balances his accounts annually on the 31st December. On the 31st March he has a fire which destroyed all his stock. £850 was obtained from the salvage. His records of purchases and sales are preserved and show: Opening Stock, £6,000; Purchases, £8,200; Sales, £10,500. Prepare an account on which his insurance claim can be based. (I.B.)

O. What is a Manufacturing Account? Give the items you would expect to find included in this account, and explain the meaning of the terms "Prime Cost" and "Cost of Production."

P. From the following particulars prepare Manufacturing and Profit and Loss Accounts, showing the cost per article sold under the different headings of Expenses; also (1) the Factory Cost, (2) Expenses of Distribution, (3) Total Cost, (4) Net Profit, per article sold. The Sales consist of articles all sold at £20 each.

	£		£
Manufacturing Wages	3,006	Machine Repairs	501
Office Salaries	2,004	Machine Depreciation	668
Sales	20,040	Opening Stock	3,000
Purchases	6,630	Closing Stock	5,622
Rent (Factory)	1,002	General Expenses	1,670
Rent (Office)	1,336	Commission	501
Motive Power	1,503	Carriage Inwards	334

There is no work in progress. (I.B.)

Q. The Finsbury Manufacturing Co., Ltd., had a Nominal Capital of £60,000 divided into 30,000 6 per cent Preference shares at £1 each, and 30,000 Ordinary shares of £1 each. Their books showed the following balances on the 31st December, 19..—

	£		£
Debtors	8,000	Works in Progress	16,000
Lease	6,000	Lease Reserve	2,300
Cash on account of Works in Progress	5,000	Cash	4,450
Profit and Loss Credit balance	200	Materials	48,000
Stock	2,000	Rent	200
Salaries	2,600	Wages	51,000
Ordinary Share Capital	30,000	Work Executed	122,000
6% Pref. Share Capital	20,000	Motive Power	900
Sundry Creditors	800	Goodwill	17,000
Carriage Inwards	700	General Expenses	880
Machinery	21,000	Calls in Arrear—Preference Shares	1,000
Interim Dividend on Preference Shares	570		

Prepare Manufacturing and Profit and Loss Accounts for the year ended 31st December, 19.., and Balance Sheet as at that date after allowing for—

	£
Depreciation on Machinery	1,500
Reserve for Bad Debts	500
The Closing Stock is valued at . . .	1,800
And the Works in Progress at . . .	7,000

Add an Appropriation Account allowing for the balance of dividend on the Preference shares, 10 per cent dividend on the Ordinary shares, £500 for Directors' Fees, £2,000 to General Reserve Account, and carry forward the balance. (I.B.)

R. What is meant by the term "single-entry" book-keeping? Describe its shortcomings, and submit a *pro forma* Balance Sheet prepared under this system. (R.S.A.)

S. Describe the shortcomings of single-entry book-keeping. State how you would convert a single entry set of books to the double-entry system in the following circumstances—

(*a*) A Cash Book is kept, but the only items posted are those relating to personal accounts.

(*b*) Payments into the bank are recorded only in the paying-in book counterfoils.

(*c*) A Sales Book is kept, but is posted only to the personal accounts of the Debtors.

(*d*) No records of purchases exist except brief details on the counterfoils of the cheque book. The personal ledger accounts of creditors are written up from the same source.

(*e*) Discounts and allowances appear only in the personal accounts of debtors and creditors. (R.S.A.)

T. A retailer, trading in electrical goods, keeps his books on a single-entry system. What alterations must he make in his book-keeping in order to adopt the double-entry system? (C.R.A.)

U. (*a*) Define single entry, and state briefly the disadvantages of this system.

(*b*) A manufacturer, Philip Morgan, kept his books on what is known as the single-entry system. The position of the business at the 31st December, 19.., revealed the following—

	£
Freehold Premises	1,000
Plant and Machinery	600
Stock-in-trade	1,300
Sundry Debtors	1,750
Cash at Bank	300
Sundry Creditors	1,875

At the 1st January, his capital was £5,500. During the year his drawings amounted to £500, and the sale of his private motor-car realized £200, which he paid into the business bank account. You are required to prepare the Statement of Affairs, showing the financial position of Philip Morgan as at the 31st December, 19..; compile his Capital Account at that date and ascertain his Profit or Loss for the year. (R.S.A.)

V. Describe the steps you would take in order to prepare a Trading Account, Profit and Loss Account, and Balance Sheet from a set of books which had been kept upon the single-entry system. (L.C.C.)

W. Robert Webber keeps his books by the single-entry method. His financial position on 1st January was as follows—

	£	*s.*	*d.*
Cash in hand	12	10	–
Stock-in-trade	642	15	–
Fixtures and Fittings	89	–	–
Cash at Bank	153	–	–
Sundry Debtors	421	10	–
Machinery and Plant	981	–	–
Sundry Creditors	1,209	15	–

During the year Robert Webber withdrew from the business, for private purposes, the sum of £480. On 31st December, Webber's financial position was as follows: Machinery and Plant, £1,350 10s.; Fixtures and Fittings, £80 10s.; Sundry Debtors, £732; Stock-in-trade, £950 10s.; Cash in hand, £15; Bank Overdraft, £500; Sundry Creditors, £1,400 10s. From the above particulars prepare a Statement showing the profit made by Webber for the year ended 31st December. When preparing this Statement, no depreciation need be written off any of the assets, and no provision for Bad and Doubtful Debts is necessary. (L.C.C.)

X. Submit a specimen ruling for an Investment Book, and explain (1) the apportionment necessary when an investment is purchased (and sold) *cum. div.*, and (2) what entry must be made to bring into account outstanding income due, but not received, at balancing time.

Y. The following transactions A. B. had with his London broker, John Statham. On the 18th March he buys £15,000 New Zealand 3½ per cent 1940 Stock at 106¾, £7,000 Victoria 4 per cent 1881 Inscribed at 104⅜, and £5,000 Natal 4 per cent Inscribed 1937 at 119¼. On these transactions the broker charges a commission of ⅛ per cent. On the 25th March he sells the New Zealand Stock at 107¼, and the Natal Stock at 120½, the Victoria Stock being carried forward, Contango being charged at one-eighth.

You are asked to show how these transactions would appear in John Statham's Ledger. (L.C.C.)

Z. Describe the best method of keeping the accounts relating to the investments of an individual or a firm, and record the following transactions in the books you would recommend—

On 3rd May, Robert Rene bought £2,000 Arcadian Government 5 per cent Bonds at 95 plus 2s. 6d. per cent brokerage and 18s. stamps.

On 30th September of the following year he sold a £1,000 of these Bonds at 98 less £3 10s. expenses. Interest on the Bonds is payable on 1st January and 1st July of each year.

Ignore all questions of income tax. (R.S.A.)

CHAPTER XI

BANKRUPTCY AND COMPANY LIQUIDATION

WHEN the financial position of a person becomes so embarrassed or doubtful and, as a result, he is unable to meet his obligations, the control of his affairs, by a process known as bankruptcy, is taken over and exercised on his behalf for the purpose of satisfying those persons to whom he is indebted. The assets that he possesses are converted into cash, and payment is made to his creditors to the extent that the proceeds will permit.

The somewhat synonymous expressions "bankruptcy" and "liquidation" should not be confused. The meanings of these two terms are not the same. A person who is insolvent in so far as he is unable to meet his liabilities is not necessarily a bankrupt, for bankruptcy implies the performance of a certain act, known as an "act of bankruptcy," which is of such a nature as to amount to an admission or an indication that he is not in a position to satisfy the claims of his creditors. To this extent, therefore, a person may be insolvent for some time before he commits an act of bankruptcy. A debtor is said to have committed such an act in the following cases—

1. *Conveyance of Property.* If he makes a conveyance or assignment of his property to a trustee or trustees for the benefit of his creditors generally.

2. *Fraudulent Conveyance.* When he makes a fraudulent conveyance, gift, or transfer of the whole or a part of his property.

3. *Fraudulent Preference.* When he makes a conveyance or transfer of his property as a result of which preference is shown to a certain creditor or a number of creditors.

4. *Keeping House, etc.* If, with intent to defeat or deceive his creditors, he departs from his place of residence or

absents himself or otherwise avoids the service of writs upon him.

5. *Levy of Execution.* When execution has been levied against him by the seizure of his goods, and the goods have been either sold or retained by the sheriff for twenty-one days.

6. *Filing Petition.* If he files a declaration of his inability to pay his debts or presents a bankruptcy petition against himself.

7. *Bankruptcy Notice.* If, when a bankruptcy notice has been served upon him, and execution thereon has not been stayed, he does not within seven days of such notice either comply with its requirements or show to the satisfaction of the Court that he has a counterclaim at least equal to the amount of the judgment debt.

8. *Suspension of Payment.* If he gives notice to any of his creditors that he has suspended, or is about to suspend, payment of his debts.

Bankruptcy proceedings, which are governed by the Bankruptcy Act, 1914, and its Amendment Act of 1926, are first instituted by the presenting of a petition, verified by affidavit. This petition may be filed by the creditor, or, as is shown above, by the debtor himself. The creditor may only petition provided—

(*a*) The debtor has committed an act of bankruptcy within three months of the date of the petition; and

(*b*) The debt in question is an ascertained figure and amounts to £50 or over. A number of creditors may combine to satisfy the second provision.

The Court to which application is made may grant the petition at its discretion, but if the petition is granted, a receiving order is made against the debtor. The effect of this order is to deprive the debtor of the ownership of his goods and assets, the property in which is transferred to the Official Receiver. This fact is usually advertised in the Press, and a time is fixed up to which the claims of creditors will be considered. A creditor proving a debt must do so on the prescribed form of affidavit, which requires to be stamped on being made.

Statement of Affairs.

Following the granting of the petition, the debtor is required to compile a list of his assets and liabilities, in the form prescribed by law, and to prepare a Statement of Affairs for submission to the Official Receiver and the creditors. This statement must be submitted within three days of the receiving order if made on the debtor's petition, or within seven days if made on the petition of a creditor. One of the first acts of the Official Receiver is to call a meeting of the creditors, at which it is decided whether bankruptcy proceedings shall be continued or whether a scheme of composition can be arranged. If the latter course is adopted, the receiving order is annulled and such a scheme is drawn up. In those cases in which an amicable understanding is not possible, the receiving order is proceeded with, a Statement of Affairs compiled, and when adjudication has been made, the debtor is required to attend a public examination of his affairs. After this examination the debtor may apply for his discharge, which may be given to him at once or which may be suspended conditionally or unconditionally, according to the circumstances of his default.

The Statement of Affairs is a list of the debtor's assets and liabilities at a specified date, and, for this reason, many students confuse it with the Balance Sheet. The difference between the two schedules of balances lies in the fact that the Statement of Affairs is concerned primarily with the realizable value of assets, not the book values, and that the assets included in the Statement are only those "free from any charge." Further, distinction is made between the various classes of creditors and their rights to payment. The object of the Statement of Affairs is to calculate anticipated indebtedness, and to ascertain what monetary payment the creditors can expect in settlement of the amounts due to them; whereas the Balance Sheet is compiled to show the financial position of a continuous business.

A description of the manner in which the prescribed form of the Statement of Affairs is prepared considerably taxes

one's mental capacity, and for examination purposes, the form adopted in the example on page 288 will suffice. From this it will be noted that the statement is prepared from a list of balances, particulars of which must be recorded on a number of schedules lettered "A" to "L." A brief note is given below on the meaning and contents of these in order that the reader may be able to follow the full method of compilation.

List "A"—Unsecured Creditors. This will include all cash and trade creditors whose claims on the business are not identified with any particular asset; holders of promissory notes and bills payable.

List "B"—Creditors Fully Secured. Creditors who hold some security for their debts, such as a mortgage or lien on the property of the debtor, must be separately stated, together with details of the security held.

List "C"—Creditors Partly Secured. Here must be recorded the creditors who hold insufficient security to satisfy their total claims. The value of the security is deducted from the claim, the balance only being extended to the column, "Expected to rank for Dividend."

List "D"—Liabilities of Debtor on Bills Discounted. This contains particulars of those unmatured bills to which the debtor is a party either as drawer or endorser, including bills discounted with bankers. Bills which the debtor has *accepted for value*, i.e. bills payable, *will appear in List "A."*

List "E"—Contingent and Other Liabilities. These will include claims which may arise under agreements of suretyship and guarantee, uncompleted contracts, loans, etc.

List "F"—Creditors for Rent, etc., Recoverable by Distress. A landlord can distrain for six months' rent if such distraint is made after the commencement of the bankruptcy. He must prove any balance of rent as an unsecured creditor. Particulars of claims for gas, water, and electric light, where power to distrain is given, will also be included in this list.

List "G"—Preferential Creditors for Rates, Taxes, and Wages, etc. Creditors whose claims are preferential may be classified in accordance with the details specified in the following paragraphs—

1. All parochial and other local rates due from the bankrupt, at the date of the receiving order, and having become due and payable within twelve months next before that time, and all assessed taxes, land tax, and property or income tax assessed on the bankrupt up to the 5th April next before the date of the receiving order, and not exceeding in the whole one year's assessment.

2. All wages or salary of any clerk or servant in respect of services rendered during four months before the receiving order, not exceeding £50.

3. All wages of any labourer or workman not exceeding £25, whether payable for time or for piecework, in respect of services rendered to the bankrupt during two months before the date of the receiving order.

4. Compensation awarded under the Workmen's Compensation Acts if the bankrupt is not covered by insurance. Where the award is covered by insurance, the rights against the insurance company are transferred from the bankrupt employer to the workman.

5. Employer's contributions due under the National Insurance Acts, payable during twelve months before the date of the receiving order.

6. The funeral and other expenses of a deceased bankrupt.

7. Money held or other property belonging to a friendly society in the hands of the bankrupt, as an officer of the society, by virtue of the office he holds.

8. Premiums paid to the bankrupt by an articled pupil, calculated by the term of the articles or apprenticeship unexpired.

List "H"—Property. This will include any bank balance, cash in hand, stock, machinery and other business assets, household furniture, and other personal effects, at both cost and realizable values. Assets in any way charged or secured will not appear in this list.

List "I"—Debts Due to the Estate. Amounts due to the debtor are classified into "good," "doubtful," and "bad." An estimate must be given in respect of the anticipated value of those debts considered to be "doubtful."

List "J"—Bills of Exchange, Promissory Notes, etc., Available as Assets. Details of bills and notes held by the debtor are entered in this list.

List "K"—Deficiency Account. The Statement of Affairs will reveal the deficiency of the debtor, and it is the object of the Deficiency Account to explain how this deficiency has arisen. The position of the debtor is ascertained at a date twelve months or more before that of the receiving order. His capital is debited to the account, as are any net profits and miscellaneous income for the period under review. On the credit side appear the trading losses, bad debts, drawings for private purposes, and the losses made on the realization of the assets. The final balance must be the same as that disclosed in the Statement of Affairs.

List "L"—In Substitution for Such of the Sheets "A" to "J" as Will Have to be Returned Blank. This is used in the case of small bankruptcies. The debtor fills in the letter of each sheet and writes the word "nil" opposite the titles of those lists on which no entries are made.

The foregoing remarks give a general idea as to the various items which are included in the Statement of Affairs, and a useful summary of these may be made in the following way. On the *debit* side are contained particulars of (*a*) the fully secured and partly secured creditors, the value of the securities in their hands, and the estimated balance (if any) to rank for dividend; (*b*) the unsecured creditors; (*c*) the preferential creditors, and (*d*) the contingent liabilities. On the *credit* side will be shown (*a*) the estimated value of cash, property, book debts, and other assets; (*b*) any surplus from the securities held by the secured and partly secured creditors, and (*c*) the deficiency. The statement is drawn up from the totals of the individual lists already referred to, and to the extent that it is a statement of balances, the Statement of Affairs bears some resemblance to the Balance Sheet.

Two points perhaps require further attention before an example is worked. The first deals with the surplus from the securities held by the secured creditors. The claims of these creditors are deducted from the value of the security, and

the balance is transferred to the contra side of the Statement of Affairs. Where, however, the value of the security is less than the amount of the creditors, the difference has to rank for dividend in addition to the claims of the unsecured creditors. The second point concerns the preferential creditors. These appear on the debit side of the statement, but the total is not extended to the money column. Instead, transfer is made to the credit side where, as a first charge on the proceeds of the assets, the preferential creditors appear as a deduction from the estimated value thereof.

An illustration will now be given, and at this point the reader is particularly advised to note the order in which the items are given and the manner in which the statement is set out.

EXAMPLE I. From the following particulars compile a Statement of Affairs for submission to the creditors of J. M. Golding, as at 31st December, 19 . .

	Estimated to Produce			
	£	£	s.	d.
Unsecured Creditors—				
Bills Payable		847	16	9
Trade Accounts		6,329	4	1
Fully Secured Creditors (value of security £7,000)		5,600	–	–
Liabilities on Bills discounted (of which £50 is expected to rank)		750	–	–
Creditors for Rent		60	–	–
Preferential Creditors for Rates and Wages		172	6	3
Cash in Hand and at Bank		49	15	–
Stock	1,500	2,612	–	–
Fixtures	750	956	10	–
Book Debts—Goods		943	15	–
Doubtful, £376; Bad, £85	195			
Bills of Exchange	115	115	–	–

Capital at start, £4,000; Trading results, 1st year (loss), £525 6s. 4d.; 2nd year (loss), £998 10s. 6d.; 3rd year (loss), £1,847 10s. 3d. Drawings, £500 per annum.

The solution to this example appears on page 288.

Having ascertained the total deficiency of the debtor, the

STATEMENT OF AFFAIRS OF J. M. GOLDING

31ST DECEMBER, 19..

Gross Liabilities	Liabilities		Expected to Rank
£ s. d.		£ s. d.	£ s. d.
7,177 – 10	Unsecured Creditors (A) . .		7,177 – 10
5,600 – –	Fully Secured Creditors (B) . .	5,600 – –	
	Value of Security . . .	7,000 – –	
	Surplus to contra . . .	1,400 – –	
750 – –	Liability on Bills Discounted (D) .	750 – –	50 – –
60 – –	Creditors for Rent (F)	60 – –	
172 6 3	Preferential Creditors for Rates and Wages (G)	172 6 3	
	Per Contra	232 6 3	
			£7,227 – 10

Assets		Expected to Produce
	£ s. d.	£ s d.
Property (H)—		
Cash at Bank and in Hand . .		49 15 –
Stock	2,612 – –	1,500 – –
Fixtures	956 10 –	750 – –
Book Debts (I)—		
Good		943 15 –
Doubtful	376 – –	
Bad	85 – –	
	461 – –	195 – –
Bills of Exchange (J)		115 – –
Surplus from Secured Creditors per contra		1,400 – –
Total Assets . .		4,953 10 –
Less Preferential Creditors for Rates and Wages and Creditors for Rent per contra . . .		232 6 3
Net Assets . . .		4,721 3 9
Deficiency		2,505 17 1
		£7,227 – 10

events to which this position can be attributed may now be explained by means of a Deficiency Account, which is described on page 286. Taking the foregoing example of J. M. Golding for the purpose of illustration, the Deficiency Account would have the following appearance.

DEFICIENCY ACCOUNT, 31ST DECEMBER, 19..

	£ s. d.		£ s. d.
Capital at commencement	4,000 – –	Trading Losses—	
		1st year	525 6 4
		2nd year	998 10 6
		3rd year	1,847 10 3
		Drawings, 3 years	1,500 – –
		Estimated Losses on Realization—	
		Stock	1,112 – –
		Fixtures	206 10 –
		Bad Debts	266 – –
Deficiency	2,505 17 1	Liability on Bills Discounted (expected to rank)	50 – –
	£6,505 17 1		£6,505 17 1

It was stated earlier on that under "List H" a return had to be made of personal property and household effects, which presupposes that when a partnership becomes bankrupt the members thereof must dispose of their personal belongings to discharge the debts of the firm. So far as is possible, the estates are kept apart, although, for the sake of economy, it is customary for the same person to administer both the partnership and personal estates. The proceeds realized from the sale of the partnership or joint estate shall first be applied in the payment of the obligations of the firm, and each separate estate in payment of the separate or personal debts of each partner. If there is a surplus on the joint estate, this goes to the separate estates for the benefit of the separate creditors and, similarly, a surplus on the separate estate goes to the joint estate for the benefit of the joint creditors.

Appointment of Trustee.

At the meeting of the creditors it is not unusual for a trustee to be appointed who, after giving to the Board of Trade such security as is required, takes over the control of the debtor's

affairs from the Official Receiver. The creditors may also appoint from their number a committee of inspection to assist the trustee in his operations. After the appointment has been sanctioned by the Board of Trade, the trustee commences to dispose of the assets of the debtor and to distribute the proceeds to the preferential and unsecured creditors. In order to keep an account of his dealings, the trustee is required to use certain books, chief of which are a Cash Book and a Record Book. The former contains the details of his cash receipts and payments, a specimen of which appears on page 291. The Record Book is used to enter up the proceedings of all meetings, the resolutions passed and the decisions come to. In addition to these, the trustee will be required to keep a Trading Account where the business of the debtor is carried on for the benefit of the creditors. When he has fulfilled the object for which he was appointed, or at the end of every six months, the trustee must render an account of his receipts and payments to the Board of Trade, by whom it is audited.

If the creditors so decide, the trustee is entitled to remuneration, which may be fixed by the creditors themselves, by the committee of inspection, or by the Board of Trade. This is usually in the nature of a percentage or commission based on the total sum realized from the sale of assets and the dividend distributed amongst the creditors.

All money received must be paid by the trustee into the "Bankruptcy Estates Account" at the Bank of England unless the use of a local bank is authorized. Any balance in this account after the unsecured creditors have received payment in full with interest, and after every other item of expense and charge has been satisfied, may be returned to the bankrupt.

EXAMPLE 2. From the following details compile the trustee's Account of Receipts and Payments to the date of the first and final dividend.

Receipts. Cash, £20 15s. 9d.; Bank Balance, £174 11s. 6d.; Stock, £6,735 12s. 9d.; Fixtures, £121 9s.; Book Debts, £5,816 18s. 3d.; Bills of Exchange, £1,326.

TRUSTEE'S CASH BOOK

Dr. RECEIPTS PAYMENTS

Date	Particulars	Total	Drawn from Bank	Debts Collected	Property Realized	Receipts from Securities held by Creditors	Other Receipts	Date	Particulars

PAYMENTS *Cr.*

Voucher Nos. (in red)	Total	Paid into Bank	Costs of Realization								Allowance to Debtor	Preferential Creditors (Section 33) and Rent	Payments to Redeem Securities	Dividends Paid	Other Payments
			Board of Trade and Court Fees	Law Costs of Petition Inc. £5 Stamp	Law Costs after Receiving Order	Commission on Realization and Distribution		Charges of Auctioneer, Accountant, Shorthand Writer, as taxed	Notices in Gazette and Local Paper	Incidental Expenses, Including Possession					
						Board of Trade	Trustees								

Payments. Board of Trade costs, Court expenses, Costs of petition, £142 17s. 4d.; Taxed costs of Accountant and Shorthand Writer, £187 12s.; Advertising, £10; Postage, etc., £60 11s. 6d.; Preferential Creditors, Rent, £250; Rates, £11; Wages, £350. Trustee's remuneration, 3 per cent on sums that assets realized and 2 per cent on dividend distributed to creditors, whose claims amounted to £25,106 1s. 6d.

TRUSTEE'S ACCOUNT OF RECEIPTS AND PAYMENTS

Dr. TO DATE OF FIRST AND FINAL DIVIDEND *Cr.*

	£	s.	d.		£	s.	d.
To Cash in Hand	20	15	9	By Board of Trade costs, Court expenses and Costs of Petition	142	17	4
,, Cash at Bank	174	11	6	,, Trustee's Remuneration— 3% on £12,674 realized	379	4	5
,, Stock	6,735	12	9	2% on £12,553 0s. 9d. distributed[1]	251	1	3
,, Fixtures	121	9	–	,, Taxed Costs of Accountant and Shorthand Writer	187	12	–
,, Book Debts	5,816	18	3	,, Advertising	10	–	–
, Bills of Exchange	1,326	–	–	,, Postage, etc.	60	11	6
				Total Expenses	1,031	6	6
				,, Preferential Creditors— Rent	250	–	–
				Rates	11	–	–
				Wages	350	–	–
				,, First and Final Dividend of 10s. in the £ on £25,106 1s. 6d.	12,553	–	9
£	14,195	7	3	£	14,195	7	3

[1] This is ascertained by calculating $\frac{2}{102}$ of £12,804 2s. which is the amount distributed to the creditors plus trustee's remuneration.

DEEDS OF ARRANGEMENT

To avoid the stigma which would attach to the debtor, and the expense and publicity of bankruptcy proceedings, it is sometimes agreed to take advantage of the provisions of the Deeds of Arrangement Act, 1914, under which the property of the debtor may be held in trust for the benefit of his creditors. The execution of a deed of arrangement, which embodies the terms arrived at between the debtor and the creditors, is in itself an act of bankruptcy, and remains available as such for a period of three months after its execution, during which time a dissentient creditor may present a bankruptcy petition against the debtor, founded on the executed deed. Should the debtor be declared bankrupt within three months

of the execution of the deed, the latter becomes void. For this reason, it is usual to allow three months to elapse before distributing any of the proceeds collected under the deed of arrangement.

The chief form which the deed may assume is that under which the debtor assigns to the trustee the whole of his property for the benefit of the creditors generally, in consideration of their granting him a full release from his obligations to them. Other arrangements, which do not involve the realization of assets, are entered into with a view to assisting the debtor to retrieve his position. Among these are—

1. A Deed of Composition as a result of which the debts are compounded by the payment of a stipulated amount or by a number of instalments.

2. An arrangement by which the business of the debtor is carried on for the benefit of the creditors with a view to total payment, or a composition.

3. An agreement whereby the debtor himself carries on business subject to the supervision of a trustee appointed for this purpose.

The accounts to be kept when a deed of arrangement is entered into are practically the same as those used by the trustee in bankruptcy, with the chief exception that no official forms are necessary. The Statement of Affairs is compiled in the usual way and the trustee must file an account of his receipts and payments.

EXAMPLE 3. Timkin and Bole are in partnership, sharing profits and losses equally. Having made heavy losses they

Liabilities	£	*Assets*	£
Creditors—		Cash	64
Open Accounts	7,534	Debtors	1,844
Bills Payable	1,026	Stock	5,312
Bank Overdraft (Southern Bank)	4,400	Fittings	250
		Plant	3,700
		Capital Accounts—	
		Timkin	876
		Bole	914
	£12,960		£12,960

call a meeting of their creditors, at which the statement shown on page 293 is presented, and offer them a payment of 10s. in £, the which is accepted.

The assets were realized as follows: Debtors, £1,215; Stock, £4,860; Fittings, £210; Plant, £1,673. The realization costs amounted to £412. The partners had no further property. Draw up the accounts showing the realization of the assets and the return to the creditors and to the partners.

Dr. REALIZATION ACCOUNT *Cr.*

19..		£	19..			£
	To Sundry Assets .	11,106		By Cash (Proceeds of Realization) .		7,958
	,, Cash (Expenses) .	412		,, Balance—Loss on Realization, c/d .		3,560
		£11,518				£11,518
	To Balance b/d .	3,560		By Capital A/cs—		
				Timkin . .		1,780
				Bole . .		1,780
		£3,560				£3,560

Dr. CREDITORS' ACCOUNT *Cr.*

19..		£	19..			£
	To Cash—			By Balances—		
	Open Accounts .	3,767		Open Accounts .		7,534
	Bills Payable .	513		Bills Payable .		1,026
	Southern Bank .	2,200		Bank Overdraft .		4,400
	,, Balance c/d .	6,480				
		£12,960				£12,960
	To Capital A/cs—			By Balance b/d .		6,480
	Timkin . .	3,240				
	Bole . .	3,240				
		£6,480				£6,480

Dr. CASH BOOK *Cr.*

19..		£	19..			£
	To Balance . .	64		By Realization A/c (Expenses) .		412
	,, Realization A/c (Proceeds) .	7,958		,, Sundry Creditors .		6,480
				,, Balance c/d .		1,130
		£8,022				£8,022
	To Balance b/d .	1,130		By Capital A/cs—		
				Timkin . .		584
				Bole . .		546
		£1,130				£1,130

Dr. TIMKIN—CAPITAL ACCOUNT *Cr.*

19..		£	19..		£
	To Balance	876		By Creditors' A/c	3,240
	,, Realization A/c	1,780			
	,, Cash	584			
		£3,240			£3,240

Dr. BOLE—CAPITAL ACCOUNT *Cr.*

19..		£	19..		£
	To Balance	914		By Creditors' A/c	3,240
	,, Realization A/c	1,780			
	,, Cash	546			
		£3,240			£3,240

The advantage of settlement under a deed of arrangement is that by a private scheme of this character, the expenses and costs of bankruptcy proceedings are avoided and, as a consequence, the creditors usually receive a larger dividend than would be possible if the debtor were adjudicated bankrupt. Furthermore, the debtor is enabled, after having satisfied the claims of creditors in full, to carry on a business which, had bankruptcy proceedings been taken, he would have been compelled to discontinue.

COMPANY LIQUIDATION

When it is considered that the business of a company should cease, it is "wound-up" by a process known as "liquidation." Many students form the erroneous opinion that the terms "bankruptcy" and "liquidation" are analogous. This is not so, for bankruptcy refers only to the insolvent partnership or individual, and, while bankruptcy presupposes a state of insolvency, this is not the sole reason for the liquidation of a company. In addition to the company being unable to meet its obligations, liquidation may arise (*a*) because the objects for which it was formed have been achieved, (*b*) where the period fixed by its Articles of Association has expired, and (*c*) for the purpose of amalgamation or reconstruction.

The rules governing the winding-up of a company are contained in the Companies Act, 1929, and apply except where contrary expression is found in the company's articles. This process by which the company terminates its legal existence may take one of the following forms—

1. *Voluntary*, by the company itself and without outside supervision.
2. *Voluntary*, but under the supervision of the Court.
3. *Compulsory*, by order of the Court.

Application is made by petition to the Court having jurisdiction, by the company itself, by a creditor of the company, or, subject to certain provisions, by a contributory or shareholder of the company. The Statement of Affairs is compiled in much the same way as that prepared in the case of bankruptcy, except that it is modified to meet the requirements of companies and has two sections showing the deficiency as regards (*a*) the creditors and (*b*) the contributories. The lists which also have to be completed are similar to those applicable to bankruptcies. There is, however, no special list for Rent, this being used for Preferential Creditors, and List "G" for Debenture-holders. Preferential debts must be paid first in full, then the unsecured creditors *pro rata* to their claims, any balance remaining after these payments have been made being returned to the shareholders according to their individual holdings and the rights conferred by the classes of shares they hold.

There are two particular points which apply only to companies. The first concerns the power of the liquidator to make a call on the shareholders (or contributories, as they are now called) in respect of amounts due on shares not fully paid. For this purpose the liquidator must prepare two lists marked respectively List "A" and List "B." The former contains the names of all present members, and the latter those of any members who are, for any reason, contingently liable. The liability arises in this way. If a present shareholder is unable to respond to the liquidator's call for the balance unpaid on the shares he holds, and the debts of the company still remain unpaid, a past holder, who has not ceased to be a

member for more than one year from the date of the winding-up order, is liable for the unpaid balance referred to. But the debts that remain unsatisfied which have necessitated the call for unpaid capital must have been incurred by the company before the past holder ceased to be a member of the company. The second point deals with the transfer of shares. In voluntary liquidation, every transfer of shares, except that sanctioned by the liquidator, made after the commencement of the winding-up, is void. In a winding-up by, or subject to, Court supervision, every transfer of shares made after the commencement of the process, unless the Court otherwise orders, is void.

Appointment of Liquidator.

The appointment will vary with the form of winding-up adopted. In a voluntary winding-up the liquidator is appointed by the company. The commencement of the winding-up dates from the time of the passing of the resolution authorizing the cessation of business. Winding-up under Court supervision arises where, the company having decided to cease business, application is made by a creditor or a contributory for an order for the company to be wound up under supervision. In such a case, the liquidator appointed by the company continues in office or is displaced by the one appointed by the Court. In the compulsory process, the liquidator is appointed by the Court. In addition, a committee of inspection is sometimes appointed whose functions are to give sanction to certain payments, to audit the books and accounts of the liquidator, and generally to supervise the liquidation. This committee is usually representative of both creditors and contributories and the appointment is subject to the approval of the Board of Trade.

Compulsory winding-up arises in cases where—

(*a*) The company has, by resolution, resolved that winding-up take place by direct supervision of the Court.

(*b*) Default is made in filing the statutory report or delay takes place in holding the statutory meeting.

(*c*) The company does not commence business within one

year from the date of its incorporation, or suspends its business for a whole year.

(*d* The number of members is reduced, in the case of a private company, below two, or in the case of a public company, below seven.

(*e*) The company is unable to pay its debts.

(*f*) The Court is of opinion that it is just and equitable that the company should be wound-up.

Until such time as a liquidator is appointed, the Official Receiver takes charge of the company's affairs. Where, however, the Official Receiver becomes the liquidator of the company, and he is satisfied that (*a*) the transactions of the business or (*b*) the interests of the creditors or contributories, demand it, a special manager may be appointed with powers of receiver and manager. The special manager is directly responsible to the Official Receiver for his acts and must account to the latter for all his dealings and transactions.

The powers of the liquidator vary according to the method of winding-up. In voluntary winding-up, the liquidator acts almost entirely on his own responsibility. When under supervision, the powers of the liquidator will be the same as in voluntary, except where these are stipulated or restricted by the terms of the order of appointment. In compulsory winding-up, sanction by the Court or the Committee of Inspection is necessary for the majority of the liquidator's acts.

Liquidator's Accounts.

The Statement of Affairs and the Deficiency Account to be prepared by the liquidator bear a close resemblance to those prepared by the trustee in bankruptcy. The principal books which the liquidator will keep are: (1) a Cash Book, into which is entered a list of his receipts and payments; (*b*) a Record or Minute Book, which will contain the minutes of all meetings and the authority for all acts that require sanction, and (3) a Trading Account, which is a record of all income received and expenditure paid in the course of carrying on the business of the company preparatory to its final dissolution. In addition to these special books and records,

the liquidator will be required to enter up the usual subsidiary books and ledgers ordinarily used by the company, or employ an accountant for this purpose.

The Cash Book will be subject to audit by the Committee of Inspection every three months, and, at half-yearly intervals from the date of the winding-up order and following the final distribution of assets, copies of the Cash Book and the necessary vouchers, together with the audit certificates of the Committee of Inspection, must be submitted to the Board of Trade. This, however, applies only to compulsory winding-up. The accounts of the liquidator in voluntary winding-up will be passed by the company in general meeting, which also has power to grant his release. After the complete realization of all property and the distribution of the proceeds, the liquidator, in compulsory winding-up, compiles a summary or final account which is sent to the creditors and contributories, and thereafter applies for his release to the Board of Trade. If this is granted, it discharges him from all liability in respect of his administration of the company's affairs.

EXAMPLE 4. From the following particulars prepare the Statement of Affairs of Peter Clark, Ltd. (in voluntary liquidation), as at 30th September, 19 . .

Issued Capital—	£
25,000 Ordinary Shares of £1 each, fully paid	25,000
25,000 6% Preference Shares of £1 each, fully paid	25,000
7% Debentures	30,000
Land and Buildings (£17,490) estimated to realize	14,750
Plant and Machinery (£18,000) estimated to realize	10,000
Book Debts—	
Good	13,685
Doubtful, £3,215 } Bad, £860 } estimated to realize	1,852
Stock (£11,320) estimated to realize	5,000
Unsecured Creditors	10,800
Fully Secured Creditors (who hold mortgage on Lands and Buildings)	9,600
Cash in Hand	80
Cash at Bank	460
Preferential Creditors—	
Rates and Taxes	225
Wages	1,100
Bills Payable	2,000

The solution to this example is given overleaf.

PETER CLARK, LTD.

Statement of Affairs as at 30th September, 19..

(a) As regards Creditors

Gross Liabilities	*Liabilities*	Amount	Expected to Rank	*Assets*	Book Values	Expected to Produce
£		£	£		£	£
12,890	Unsecured Creditors (A)		12,800	Property (H)—		
9,600	Fully Secured Creditors (B)	9,600		Cash in Hand		80
	Value of Security	14,750		Cash at Bank		460
				Plant and Machinery	18,000	10,000
	Surplus to contra	5,150				
				Stock	11,300	5,000
	Preferential Creditors for Rates, Taxes, Wages and (F)	1,325		Book Debts (I)—		
				Good		13,685
1,325	Deducted per contra			Doubtful	3,215	
30,000	Debentures (G)	30,000		Bad	860	1,852
	Deducted per contra					
				Surplus from Secured Creditors per contra		5,150
				Total Assets		36,227
				Deduct Preferential Creditors as per contra		1,325
						34,902
				Deduct Debentures as per contra		30,000
				Net Assets		4,902
				Deficiency		7,898
			£12,800			£12,800

(b) As regards Contributories

	£		£	
Capital Issued—		Total Deficiency	57,898	
25,000 £1 Ordinary Shares	25,000			
25,000 £1 Preference Shares	25,000			
Deficiency as per Statement of Affairs	7,898			
	£57,898		£57,898	

EXAMPLE 5. From the particulars in Example 1 prepare Liquidator's Cash Account assuming (*a*) that the realized values of all assets were collected, including surplus from Secured Creditors, (*b*) that the expenses and costs of the liquidation amounted to £568, and (*c*) that the liquidator's remuneration totalled £814.

Dr. LIQUIDATOR'S CASH ACCOUNT *Cr.*

		£			£
	To Balances	540		By Liquidation Expenses	568
	„ Proceeds from Realization of Assets—			„ Liquidator's Remuneration	814
	Plant and Machinery	10,000		„ Preferential Creditors	1,325
	Stock	5,000		„ Debenture-holders	30,000
	Book Debts	15,537		„ First and Final Dividend of 5s. 6d. in the £ to Unsecured Creditors, £12,800	3,520
	„ Surplus from Secured Creditors	5,150			
		£36,227			£36,227

EXAMPLE 6. The X Y Z Company, Ltd., went into voluntary liquidation on 1st June, 19.. The following are particulars from which must be prepared the Liquidator's Final Account for submission to a meeting of the shareholders—

	£
Cash at Bank at date of Winding Up	170
Calls in Arrear collected	1,500
Stock realized	700
Fixtures realized	180
Book Debts	1,500
Preferential Creditors for Wages	120
Trade Creditors	2,000
Bills Payable	525
Legal and Liquidation Expenses	255
Liquidator's Remuneration	00
Machinery and Plant realized	700

The Subscribed Capital of the company was £20,000 in Ordinary shares of £1 each, fully called up.

THE X Y Z CO., LTD. (in Liquidation)
LIQUIDATOR'S FINAL ACCOUNT

Receipts	£	*Payments*	£
To Balance in Bank	170	By Legal and Liquidation Expenses	255
„ Proceeds of Realization of Assets—		„ Liquidator's Remuneration	100
Furniture and Fixtures	180	„ Preferential Creditors	120
Machinery	700	„ Trade Creditors	2,000
Book Debts	1,500	„ Bills Payable	525
Stock	700	„ Shareholders—First and Final Dividend of 1s. 9d. in the £ on 20,000 Shares of £1 each	1,750
Calls Collected	1,500		
	£4,750		£4,750

Receivers.

A receiver is one who is appointed by a group of persons to watch over their interests. The appointment presumes the condition of insecurity and may be made on the application of the debenture-holders under the terms of issue of the stock they hold, i.e. when default has occurred in the payment of interest, or by the creditors of a company in cases where their interests have become in any way endangered. Appointment by the Court has the effect of transferring the income or property of the company to the receiver appointed.

The receiver's duty is to take possession of the assets charged by the debentures and, under the direction of the Court, to realize them and then, after paying the costs and his own remuneration, to distribute to the debenture-holders such sums as are due to them. Where both a receiver and a liquidator are appointed to administer the affairs of an insolvent company, the liquidator can deal only with those assets which are not charged or mortgaged by the instruments in the hands of the debenture-holders. In those cases in which it is to the mutual advantage of the debenture-holders, the creditors, and the shareholders, the Court may appoint the same person to the office of receiver and of liquidator. The accounts which the receiver will keep are similar to those already outlined in the winding-up process.

EXERCISE XI

A. Enumerate briefly the acts of bankruptcy. (C.R.A.)

B. What are the requisites for a valid petition for bankruptcy proceedings to be presented against the debtor? (C.R.A.)

C. What items are usually contained in the Statement of Affairs? Give a brief description of each, and state within what period of time this Statement must be submitted.

D. Give a short *résumé* of the contents of the lists which have to be presented with the Statement of Affairs.

E. What is the object of the Deficiency Account? Submit a *pro forma* example.

F. What are "Preferential Creditors"? In which list are their claims entered?

G. What is the position of a landlord in the event of an execution being levied on his tenant's goods? (C.R.A.)

H. Explain the position of a secured creditor in the event of the bankruptcy of his debtor. (C.R.A.)

I. How is a Trustee appointed and paid? On what grounds may the Board of Trade object to any particular person as such? (C.R.A.)

J. How, and by whom, is the remuneration of a Trustee in bankruptcy determined?

K. The Trustee in bankruptcy keeps a cash book showing receipts and payments from day to day in connection with the estate. How often must this book be submitted to the Committee of Inspection for audit? What copies thereof and vouchers must he send from time to time to the Board of Trade? How does he show to the Board the progress of his administration? (C.A.A.)

L. When is the first meeting of creditors held in bankruptcy proceedings, and what is the object of that meeting? (C.A.A.)

M. What is a deed of arrangement? How does it differ from a scheme of composition (or arrangement) in bankruptcy? (C.R.A.)

N. A, a debtor, on the 10th October, 19.., assigned his property to a trustee for the benefit of his creditors. A creditor now proposes to present a bankruptcy petition against A. Within what time must this be presented? Is it necessary for the petitioner to show an intention by the debtor to defeat creditors? If the deed is registered under the Deeds of Arrangement Act, 1914, what rights (if any) has a dissenting creditor to present a petition on this ground? (C.A.A.)

O. What is a "Scheme of Composition"? How is it brought about and what is its effect? (C.R.A.)

P. P. Parenthesis, finding that he is unable to meet his liabilities, calls a meeting of his creditors (whose claims amount to

£13,000) and submits a statement showing his financial position. Submit a *pro forma* statement disclosing particulars of the position of affairs, and state what dividend can be paid to the creditors if the assets realize the valuations placed upon them. (R.S.A.)

Q. What is the difference between the Statement of Affairs compiled by the debtor in bankruptcy and that prepared by the liquidator in winding-up.

R. What is meant by a "Committee of Inspection"? How is this committee appointed and what are its functions?

S. What books may a liquidator keep? Describe briefly the uses of each. By whom are the books and accounts audited?

T. From the following particulars prepare a Statement for submission to the Creditors in an insolvency in which you have been appointed Trustee under a Deed of Arrangement, showing the probable amount in the £1 available for dividend. The Trustee's remuneration is to be estimated at £60—

	£
Cash	10
Debtors—Good	300
Doubtful	400
Expected to realize	100
Bad, no value	700
Loan to a relation	200
Expected to realize	nil
Plant (valued at £400)	800
Office Furniture (valued at £50)	200
Stock	1,000
Expected to realize	700
Preferential Creditors	300
Unsecured Creditors	5,000
Bills Payable	3,000

(C.A.A.)

U. The Bubble Co., Ltd., went into Voluntary Liquidation with Unsecured Creditors, £12,000, and Preferential Creditors, £2,171. There was £50 in the bank at the commencement of the liquidation. The Assets realized £6,640—Book Debts, £4,280, and Auction Sale of Stock and Plant, £2,360. The costs of the liquidation were £44. The liquidator is to be allowed 3 per cent on the amount realized, and 2 per cent on the amount distributed to unsecured creditors. Prepare the liquidator's Final Account. (C.A.A.)

V. H. Harvey is in financial difficulties. From the following particulars prepare a statement to submit to a meeting of his creditors—

Stock, £3,500 (expected to realize £2,000).
Preferential Creditors, £550.
Creditors on open account, £4,500.

Bills Payable, £2,300.
Cash in Hand, £50.
Sundry Debtors, £1,000 (expected to realize £650).
Office Furniture, £300 (expected to realize £200).
Plant, £2,000 (expected to realize £1,100).
H. Harvey, Capital Account, credit balance, £500.
Debit Balance on Profit and Loss Account, £1,000.
Professional Charges are estimated at £50.

How much in the £ may the creditors expect to receive? (I.B.)

W. Samuel Hobson, in business in the city, finds himself insolvent. From the various books and papers in his possession, the following particulars as to his financial position are forthcoming—

	£
Sundry Debtors: Good, £1,280; Doubtful, £2,800 (estimated to produce £1,000); Bad, £700	4,780
Sundry Freehold Houses, etc. (estimated to produce £2,000)	3,300
Shares: 1,000 Ordinary Shares in the Cable Telegraph Co. valued at par	1,000
Mining and Railway Shares (£2,500 are held as security by partly-secured creditors and the balance by fully secured creditors)	9,450
Loss through the unsuccessful defence of an action at law	5,420
Business Expenses	3,200
Creditors—Unsecured	16,740
Partly secured	5,420
Fully secured	3,110
Preferential Claims for Salaries and Rent	500
Private Drawings	1,200
Samuel Hobson, Capital Account	3,800
Cash at Bank	420
Bills Receivable, Good	800

Prepare the Statement of Affairs for submission to his creditors, and a Deficiency Account in the ordinary form. (L.C.C.)

X. What is the difference (if any) either in result or in method of preparation between a Balance Sheet and a Statement of Affairs? (L.C.C.)

Y. A trustee of a bankrupt estate, with liabilities of £12,000, has completed his realization of the estate. From the following particulars compile the trustee's Cash Account—

Receipts: Stock, £4,000; Book Debts, £2,450; Plant and Machinery, £3,900; Fittings, £150.
Payments: Costs of Petition, £62; Shorthand Writer's Charges, £10; Miscellaneous Payments, £150; Legal Expenses, £44; Preferential Creditors, £956.

It was agreed by the committee that the trustee's remuneration should be 4 per cent on assets realized, and 3 per cent on the amount distributed to the unsecured creditors. State also how much in the £ the unsecured creditors received.

Z. The D.E.G. Co., Ltd., went into voluntary liquidation. The assets realized a total of £13,500, and trade creditors amounted to £3,500. The combined legal and liquidator's fees and expenses were £450. The capital of the company was £10,000, divided into 5,000 5 per cent Cumulative Preference Shares of £1 each, fully paid, with prior rights as regards capital, and 5,000 Ordinary Shares of £1 each, fully paid. In addition, the company had issued 5 per cent Debentures totalling £2,000, on which at the time of settlement six months' interest was unpaid.

From the foregoing prepare the liquidator's Final Cash Account showing the repayment of capital to the Preference and Ordinary shareholders.

CHAPTER XII

THE DOUBLE ACCOUNT SYSTEM—THE FINAL ACCOUNTS OF BANKING AND INSURANCE COMPANIES

THE double account system is the term applied to the form in which the final accounts of certain parliamentary and public companies and undertakings are required by law to be prepared. These concerns, which produce or provide a service rather than a tangible object or commodity, include railway, tramway, and gas companies, which are statutorily compelled to adopt this method, and water, electricity, mining, and similar undertakings which may employ it at discretion. The ordinary routine book-keeping is kept on the double entry principle with which the double account system should not be confused, the latter applying only to the method of compiling the final accounts. The double account system, as distinguished from the single account system, i.e. the more common method of preparing the Profit and Loss Account and the Balance Sheet, is adopted chiefly to show in what manner the capital has been expended. The capital raised by any of the companies specifically mentioned above is largely devoted to the construction of works and plant of a permanent nature, and it is, therefore, advisable to show clearly—

(*a*) The amount of capital and money raised by the issue of shares and debentures, and loans;

(*b*) The amount expended on constructing, acquiring, or extending the undertaking, and

(*c*) The amount of capital remaining for the purpose of general trading.

To give this information necessitates the Balance Sheet being prepared in two sections, and here lies the fundamental difference between the double account and single account systems. The first section, termed the "*Receipts and Payments on Capital Account*," gives on the credit side the receipts of capital divided into the various forms of which it

is composed, and on the debit side the capital outlay represented by fixed assets. The balance is carried to the second section, called the "*General Balance Sheet,*" which is prepared on much the same lines as that already described in the previous chapters, showing the floating assets and liabilities, and reserves. A further deviation from the usual Balance Sheet is that the Receipts and Payments on Capital Account is ruled with three columns on each side. This permits the recording of (*a*) the capital receipts and payments at the date of the previous account, (*b*) the capital received (or raised) and expended during the period for which the account is prepared, and (*c*) the combined totals of the two preceding columns.

Instead of the more common titles—"Trading Account" and "Profit and Loss Account," the terms "Revenue Account" and "Net Revenue Account" are introduced. The former will contain all the receipts and costs relating to the productive working of the company, and the balance is carried down to the Net Revenue Account which will include, *inter alia*, the dividends distributed, transfers to reserves, and other appropriations from profit.

Depreciation and Renewals.

One of the outstanding features of the double account system is the provision for depreciation and renewals. Provision for these items in the commercial accounts is made by periodical charges to profit and loss by means of which the balance sheet values of certain assets are reduced to their true or realizable values. Where, however, it is usual to retain the assets at their *cost* value, as in the double account system, the method of periodical reduction is not possible. Assets continue to appear at cost irrespective of loss in value, which is provided for by means of a Depreciation Fund made up of appropriations from profit. The Net Revenue Account is debited and the Depreciation Fund credited with the sum appropriated for this purpose. The balance of the Fund Account will appear in the General Balance Sheet as a liability. Where the fund is represented by specific assets, i.e. where the yearly appropriations are invested outside the business,

the total of these will appear as an asset in the General Balance Sheet.

It is customary for a special account to be opened for repairs and renewals, to which transfers are made annually from the Revenue Account. The charging of all repairs, renewals, and costs of maintenance *direct* to this special account (instead of to the Profit and Loss Account or Net Revenue Account) has the effect of equalizing the yearly charge in so far as the only item appearing in the Revenue Account will be the transfer to the Repairs and Renewals Account which is always the same. Consequently, violent fluctuations in these charges are avoided.

Objections to the System.

The system is open to several objections. First and foremost is the argument that the idea of permanency which the account gives results in anomalies. Assets remain at cost and are kept in a state of efficiency by constant charges to revenue. As a consequence, it is possible for the profits over a number of years to be incorrectly shown, for the very reason that during those years in which the costs of repairs and renewals are heavy, the profit is unfairly burdened, whilst when these costs are small, the profit is correspondingly relieved—though the assets in question render identical service year by year. Further, however much may be expended on assets by way of repairs and maintenance, the loss by obsolescence can never be adequately recovered, nor can the natural deterioration be provided for. To this extent the Balance Sheet does not represent the true state of affairs. In practice, these difficulties are overcome by the creation of specific funds for depreciation and renewals, but even when this is done, misrepresentation may still continue by virtue of the fact that assets definitely appear at above their actual value.

On behalf of the system it is held that the Capital Account, being in the nature of a Cash Account, is more readily understood by the shareholders and others who do not possess an adequate knowledge of book-keeping and accountancy. Information on one side of the account relates to the sum raised

from the public in the form of shares and debentures, and on the other side, details are given as to the nature of the assets and the property acquired with such capital. And, when it is borne in mind that a large proportion of the money raised, which in many cases runs into millions of pounds, is spent to acquire fixed assets, it is essential to furnish particulars of these assets as distinct from the floating assets of the company.

The example on page 311 shows how the "double account" is prepared in the case of a railway company. Those compiled for tramway, gas, and other companies are similarly constructed, the terms used being changed to meet the special requirements of each concern.

BANK BOOK-KEEPING

The modern functions of a banker are to-day a matter of common knowledge, and, apart from a very brief survey of these, it is intended to deal at once with a general outline of some of the more important books kept and the method of preparing the final accounts. It is to the latter that the student's attention is particularly drawn for the reason that the system of recording banking transactions is the same as that adopted by a merchant of recording ordinary trading business. The difference is in the titles of the books kept and in the various terms used. The banker trades in money and credit, and it is with these transactions that his activities are primarily concerned. The chief of his functions are—

(*a*) The receipt of deposits on Current and Deposit Accounts.

(*b*) The payment of money in the form of withdrawals and in settlement of accounts, and the granting of loans.

(*c*) The discounting and collecting of bills of exchange.

(*d*) Acting as agent for customers and other banks, and as trustee and executor.

(*e*) The buying and selling of bills of exchange and foreign currency, the issuing of capital for companies, the issuing of circular notes and letters of credit, and the collecting of interest and dividends.

THE WESTERN & SOUTH COAST RAILWAY

Receipts and Payments on Capital Account

Dr. | *Cr.*

To Expenditure	Amount Expended to 30th June, 19..	Amount Expended during the Year	Total	By Receipts	Amount Received to 30th June, 19..	Amount Received during the Year	Total
	£	£	£		£	£	£
Lines open for Traffic	1,500,000	100,000	1,600,000	Stock and Shares	1,900,000	20,000	1,920,000
Lines not open for Traffic: New Lines	200,000	50,000	250,000	Loans	400,000	—	400,000
Lines Leased	40,000	—	40,000	Debenture Stocks	500,000	—	500,000
Rolling Stock	100,000	15,000	115,000	Premium on Debenture Stocks	25,000	—	25,000
Manufacturing Works and Plant	300,000	—	300,000				
Steamboats	250,000	—	250,000				
Hotels	120,000	10,000	130,000				
Subscriptions to other Companies	75,000	—	75,000				
Total Expenditure	£2,585,000	£175,000	£2,760,000	Total Receipts	£2,825,000	£20,000	£2,845,000
Balance to General Balance Sheet			85,000				
			£2,845,000				£2,845,000

GENERAL BALANCE SHEET

As at 30th June, 19..

Dr. | *Cr.*

	£		£
Balance from Capital Account	85,000	Cash at Bankers	320,000
Sundry Creditors	60,000	Investments and Government Stocks	500,000
Superannuation Funds	230,000	Other Securities	61,500
Depreciation Fund	300,000	Stocks and Stores	220,000
Fire Insurance Fund	120,000	Outstanding Traffic Accounts	105,000
General Reserve Fund	250,000	Amount due to Railway Clearing House	60,000
Revenue Account, Balance	226,000	Miscellaneous Accounts	4,500
	£1,271,000		£1,271,000

It is with the first three classes of transactions that the book-keeping student is primarily concerned. It ought, perhaps here to be emphasized that, in view of the difference in the size and nature of the business of banking concerns, these remarks can serve only as a general guide, a guide which may need to be modified or altered to meet individual requirements. But, since the receipt and payment of cash and dealings in credit form the principal part of the banker's transactions, it is obvious that an elaborate analysis of these transactions is generally necessary.

The usual form of cash book would be totally inadequate for banking requirements. As several clerks and cashiers are receiving and paying cash at the same time, it is necessary for each clerk to keep a separate record of his daily transactions. From these books the customers' ledger accounts are written up from (*a*) the actual paying-in slip completed by the customer, (*b*) the cheque in surrender for which cash is paid, or (*c*) debit and credit notes or slips. In addition to the cash books kept by the counter cashiers and other clerks, a General Cash Book, ruled with analysis columns, will be used to record the totals of the daily cash transactions. To enter every individual item into one book would entail considerable time and space, and would not be possible when entry has to be made by a number of persons who would all probably want to use the book at the same time. So that to form a convenient summary of all transactions, the daily totals of cash received and paid are posted to the General Cash Book.

Bill dealings, which can be subdivided into several sections, to-day form a fairly large proportion of the banker's business, and separate books will therefore be kept for each section. These books are ruled with a number of columns so that details of each bill may be entered therein. A bill diary will also be used as a record of the dates on which the bills mature.

Ledger Accounts.

An account will be opened for each customer in the same way as that followed by the commercial business. The chief distinction is the inclusion in each ledger account of extra

columns for the "balance" and "interest." It is essential in banking to be conversant with the customer's position at almost any time, and to calculate this in the ordinary manner of addition and subtraction would be too cumbersome and would involve an unnecessary expenditure of time. The inclusion of columns for debit and credit balances enables the "difference" in the account to be calculated and entered when each transaction is recorded, and by this means the condition of a customer's account can be seen at a glance. Interest on deposits and loans is calculated from day to day, and it therefore becomes necessary for the accounts to be so ruled as to allow this calculation to be made with ease and rapidity, especially in those cases in which each ledger clerk has to deal with some hundreds of accounts daily. Interest is ascertained by means of tables.

The large number of transactions that ordinarily occur in a banker's day of business shows only too clearly the futility of posting the ledgers in the usual way, especially when it is borne in mind that the accounts of the customers must be prepared in such a manner as to permit the position of the account being determined at once. To meet this special requirement, a method of posting, known as the "slip system" is widely used.

The foregoing is but a cursory examination of some of the more important points with which the student of Advanced Book-keeping should be conversant. That reference to many matters has been omitted is obvious to the reader, but it must be appreciated that to make a complete survey would entail much more space than can be conveniently allotted to a work dealing generally with the whole subject of Advanced Book-keeping and not specially with a part of it. No mention has yet been made of the books and accounts kept to record the nominal expenses, such as rent, wages, and salaries, lighting and heating, office and administrative costs. These will be treated in exactly the same way as that explained in the case of the commercial business, while the bank having branch offices will record their dealings in a manner similar to that described in the chapter on Branch Accounts, although some

modifications to suit the special requirements of the business of banking will be essential.

Final Accounts.

The Profit and Loss Account, though drawn up in the usual way, is remarkable for its lack of detail, very little information being obtainable therefrom. From the example given below it will be noticed that many of the items are summarized, and thus appear only in total.

Dr. PROFIT AND LOSS ACCOUNT *Cr.*

	£		£
To Interest allowed to Customers . .		By Balance brought forward . . .	
,, Salaries and other Expenses at Head Office and Branches . .		,, Gross Profit after making provision for Bad Debts and other Contingencies and including Rebate brought forward . . .	
,, Rebate on Bills carried to New Account			
,, Bank Premises A/c .			
,, Officers' Pension and Provident Fund .			
,, Dividend for half year to .... at ....% per annum			
,, Balance carried forward			

The Balance Sheet also resembles that constructed by the commercial company, the difference being in the terms used. The student is advised to make himself familiar with the meaning of these, for examination questions dealing with the final accounts of a banking company invariably require a knowledge of the terms used. The order and method of setting out the assets and liabilities, as illustrated by the example given on page 316, should be particularly noted.

A few notes of explanation of the various terms included in the Bank Balance Sheet are given below.

Cash in Hand. This figure will include the balance held by each branch office as well as that at head office, and that standing to the credit of the bank at the Bank of England. The

last-named balance is useful in so far as transfers may be made from one bank to another after clearing-house transactions have been summarized.

Money at Call and at Short Notice represents money which, though not actually in hand, can be quickly obtained, and is usually in the form of loans to bill brokers at a low rate of interest.

Investments are classified, those capable of easy conversion being placed first.

Bills Discounted. These bills represent one of the chief, and most remunerative, sources of the banker's profit. The item indicates the total bills discounted which have not matured.

Loans and Advances to Customers. This figure denotes the loans and overdrafts made to customers and others, for which securities are lodged.

Freehold Premises. Although this term is self-explanatory, it might incidentally be mentioned that, as a result of its under-valuation, a secret or hidden reserve is very often created.

Liability on Acceptances and Endorsements. This item, which is a contingent liability, appears on both the liabilities and the assets side, and represents bills which the bank has accepted or endorsed on behalf of its customers. That the bank is able to resort to the customers, from whom the bills were received, in the event of the non-payment at their maturity, accounts for the entry on both sides of the Balance Sheet.

Rebate on Bills. This refers to the discount charged on bills discounted which have not matured at the date of the accounts and, consequently, to profit which has not been earned during the period for which the accounts are made up. The unexpired portion of this discount is, therefore, carried forward to the following year's accounts.

INSURANCE COMPANIES' ACCOUNTS

Although the terms "assurance" and "insurance" are, in practice, used to denote a contract under which the insurer undertakes to indemnify the insured against the happening

BALANCE SHEET

As at 31st March, 19..

Liabilities	£	*Assets*	£
Subscribed Capital—		Cash in Hand and at Bank of England	8,874,162
200,000 Shares of £50 each, £25 paid	5,000,000	Money at Call and Short Notice	7,894,695
Reserve Fund	2,516,000	Investments—	
Current, Deposit, and other Accounts	60,426,715	Consols and other Government Securities	2,346,871
Acceptances on behalf of Customers	2,712,410	Indian Government Stocks	406,015
Profit and Loss Account, Balance	831,627	Colonial and Foreign Government Stocks	682,740
		Sundry Investments	2,471,877
		Bills Discounted	9,014,603
		Loans to Customers and others on Security	35,176,841
		Liabilities of Customers for Acceptances	2,712,410
		Bank Premises and Fittings at Head Office and Branches	1,906,538
	£71,486,752		£71,486,752

of a certain event, there is some slight difference between the two classes of contracts entered into. The term "assurance" generally refers to life risks and to this extent to events that are bound to happen, since no human being is immune from death. "Insurance," on the other hand, is more often applied to those events of a contingent nature, i.e. fire, marine, accident, etc. As most companies undertake both types of risks, the terms may be used in a joint or composite sense.

Companies which carry on insurance business may be broadly classified into two classes—

(*a*) Proprietory, where the capital of the undertaking is subscribed by shareholders who receive dividends in the usual way, and

(*b*) Mutual, which consist of policy-holders, the whole of the profit being divided among the policy-holders either in the distribution of bonuses or in the reduction of the premiums payable.

Before beginning operations, every company which proposes to transact insurance or assurance business must deposit the sum of £20,000 with the Paymaster-General. Where several classes of business are carried on, the company must deposit an additional sum. The usual principles of double-entry book-keeping will apply to insurance accounts, but since the transactions of these companies do not extend to the buying and selling of goods, the books to be kept will be slightly different from those to which reference has already been made. The following is a general list of the more important books used, and from this it will be observed that, like the books of a banking business, these apply only to insurance transactions.

Policy Register.
Renewal Premium Register.
Premium Cash Books.
Agents' Cash Books.
General Cash Books.
Claims Register.
Investment and Dividend Registers.

Since the business of the company is largely carried on by means of numerous agents, it is essential that a rather elaborate

system of writing up the accounts from the agents' returns be employed, and to facilitate this the use of analysis columns in the various books is found to be particularly advantageous.

Final Accounts.

These are of more importance from the student's point of view, and attention is specially drawn to the difference between the method of compiling the final accounts of an insurance company and that of the ordinary trading concern. Separate accounts must be kept for each type of business transacted, and for this purpose the receipts and payments will have to be analysed; hence the reason for the creation of separate funds, namely, Life Assurance Fund, Employers' Liability Insurance Fund, etc. The preparation of the final accounts is regulated by the Assurance Companies Act, 1909, which provides that the following schedules shall be prepared at the close of each financial year—

1. A Revenue Account for each class of insurance business carried on.
2. A General Profit and Loss Account.
3. A Balance Sheet.

It is not proposed to give specimens of the schedules as set out in the Act itself, but from the example worked on pages 321 and 322 the student will obtain a good idea of the method of preparing the necessary accounts, sufficient to enable him to answer examination questions on this point.

The method of computing profit by means of a Trading Account is obviously unsuitable for the insurance company. Instead, profit is ascertained either by a process of revaluation or by reserving a specific part of the premium receipts for the purpose of meeting future claims. The first method is adopted by companies carrying on life assurance business and, by Sect. 5 of the Assurance Companies Act, 1909, this revaluation must take place once every five years. One-fifth of the surplus disclosed by this process is transferred annually to the Profit and Loss Account. Assessment of profit by means of reservation is employed by companies transacting fire, accident, and other types of insurance. Against the premium

income received will be set the various claims paid, losses and administration expenses, and of the balance 40 per cent (or such other figure as is determined by the company) will be reserved to meet claims arising from unexpired risks.

The actual preparation of the accounts differs in two respects from those of the commercial business. Firstly, the common book-keeping abbreviations, "*Dr.*" and "*Cr.*" are dispensed with, and, secondly, the items are transposed, income and gains appearing on the left-hand side, whilst expenses, losses, and other charges are shown on the right-hand side. In addition to these items, on both sides of each Revenue Account will be given the balance of the "Fund," out of which future claims may be met. The debit item refers to the state of the fund at the commencement of the period, and the credit item to the state of the fund at the close of the period. The difference between the two sides, after the closing amount of the fund has been ascertained, is transferred to the debit or credit sides of the Profit and Loss Account, according to whether a profit or a loss has been made.

The Profit and Loss Account is similar in construction to the Appropriation Account of a limited company, containing on the debit side the balance (if any) from the previous year, special receipts and income not identified with any particular section of the business, i.e. interest and dividends from general investments, and the transfers of profit from the individual Revenue Accounts. On the credit side will be shown the dividends or bonuses paid or payable to the shareholders, expenses not already charged, e.g. depreciation of securities, and the transfers of loss from the individual Revenue Accounts. The balance of the Profit and Loss Account represents undivided profit (or total loss) which appears in the Balance Sheet. It will again be noticed that the items of this account are transposed in exactly the same way as the Revenue Accounts already described.

As the Balance Sheet is drawn up in the usual manner, it is not intended to comment thereon. The method of setting out the assets and liabilities as adopted in the example worked below may be used for examination purposes. The

difference between this and the form prescribed by law is that, in the latter, details of all items must be given; for instance, mortgages, loans, and investments must be classified.

EXAMPLE I. From the following particulars of the "All-in" Insurance Company, Ltd., prepare Revenue Accounts, a Profit and Loss Account, and a Balance Sheet as at 31st December, 19 . .

TRIAL BALANCE	*Dr.*	*Cr.*
	£	£
Share Capital		600,000
British Government Securities	740,260	
Colonial Government Securities	295,600	
Property	250,000	
Sundry Debtors	4,715	
Agents' Balances	73,950	
Claims admitted but not paid		115,462
Cash	122,834	
Securities deposited with Supreme Court	20,000	
Furniture and Fittings	15,415	
Investment Reserve Fund		550,000
Profit and Loss Account, balance, 1st Jan.		14,649
Interest and Dividends		6,800
Sundry Creditors		38,910
(*a*) Fire Insurance		
Amount of Fund at 1st January, 19 . .		25,150
Claims	42,500	
Management Expenses	8,630	
Premiums		66,850
Commission	3,865	
(*b*) Accident Insurance		
Amount of Fund at 1st January, 19 . .		3,210
Claims	4,160	
Management Expenses	1,176	
Premiums		10,200
Commission	1,050	
(*c*) General Insurance		
Amount of Fund at 1st January, 19 . .		85,000
Claims	167,600	
Management Expenses	75,304	
Premiums		341,000
Commission	30,172	
	£1,857,231	£1,857,231

A reserve of 40 per cent of the premiums received is to be made in respect of unexpired risks.

THE "ALL-IN" INSURANCE CO., LTD.
REVENUE ACCOUNTS
For the Year Ended 31st December, 19..

(*a*) Fire Insurance

	£		£
Fire Insurance Fund at 1st January, 19..	25,150	Claims paid and outstanding	42,500
Premiums	66,850	Commission	3,865
		Management Expenses	8,630
		Transfer to Profit and Loss Account	10,265
		Fire Insurance Fund at 31st December, 19..	26,740
	£92,000		£92,000

(*b*) Accident Insurance

	£		£
Accident Insur'ce Fund at 1st Jan., 19..	3,210	Claims paid and outstanding	4,160
Premiums	10,200	Commission	1,050
		Management Expenses	1,176
		Transfer to Profit and Loss Account	2,944
		Accident Insur'ce Fund at 31st December, 19..	4,080
	£13,410		£13,410

(*c*) General Insurance

	£		£
General Insur'ce Fund at 1st Jan., 19..	85,000	Claims paid and outstanding	167,600
Premiums	341,000	Commission	30,172
		Management Expenses	75,304
		Transfer to Profit and Loss Account	16,524
		General Insur'ce Fund at 31st December, 19..	136,400
	£426,000		£426,000

PROFIT AND LOSS ACCOUNT

For the Year Ended 31st December, 19..

	£		£
Balance brought forward	14,649	Balance carried forward	51,182
Interest and Dividends	6,800		
Transfers from Revenue Accounts—			
Fire Insurance . .	10,265		
Accident Insurance .	2,944		
General Insurance .	16,524		
	£51,182		£51,182

THE "ALL-IN" INSURANCE CO., LTD.
BALANCE SHEET

As at 31st December, 19..

Liabilities	£	*Assets*	£
Share Capital . .	600,000	Investments—	
Fire Insurance Fund .	26,740	Deposit with Supreme Court . . .	20,000
Accident Insurance Fund	4,080	British Government Securities . . .	740,260
General Insurance Fund	136,400	Colonial Government Securities . . .	295,600
Investment Reserve Fund	550,000	Property . . .	250,000
Profit and Loss Account Balance	51,182	Furniture and Fittings .	15,415
Claims admitted but not paid . . .	115,462	Agents' Balances . .	73,950
Sundry Creditors . .	38,910	Sundry Debtors . .	4,715
		Cash	122,834
	£1,522,774		£1,522,774

EXERCISE XII

A. What are the advantages and disadvantages of the double account system? (C.R.A.)

B. By what kinds of concerns is the double account system adopted? Explain the system briefly, indicating how depreciation is dealt with in this connection. (I.B.)

C. To what class of enterprise does the system of book-keeping known as the double account system apply? Briefly explain its distinctive features as compared with the single account system. (R.S.A.)

D. Describe briefly the methods of dealing with Wasting Assets

adopted by railway companies, or any other undertaking of your own selection working under the double account system. (R.S.A.)

E. Give a *pro forma* example of a Capital Receipts and Expenditure Account under the double account system. State briefly how depreciation can be provided for under this system of accounting. (R.S.A.)

F. Explain the principles on which the accounts of an insurance company are drawn up, and the method by which the profits are periodically determined.

G. Give an example of the Balance Sheet of *one* of the following, explaining clearly but briefly the nature of any items therein peculiar to the class of undertaking in question: (*a*) a railway, (*b*) a life assurance company, (*c*) a bank. (C.A.A.)

H. Under what statute are the accounts of assurance companies controlled? Contrast the methods of ascertaining profits employed by assurance companies with those of commercial companies. (R.S.A.)

I. Briefly contrast the book-keeping requirements of a bank as compared with those of a commercial company. Describe the special methods of posting employed by banks in order to meet their particular requirements. (R.S.A.)

J. The understated items have been extracted from the accounts of a bank. Explain briefly what they represent—

"Liabilities of Customers on Acceptances as per contra" (Cr. side of Balance Sheet).

"Rebate on Bills not due" (Dr. side of Balance Sheet).

"Money at Call and Short Notice" (Cr. side of Balance Sheet).

"Bills Discounted" (Cr. side of Balance Sheet). (R.S.A.)

K. What do you understand by "Rebate on bills discounted," and how would you treat this item when preparing the Profit and Loss Account and Balance Sheet of a bank? (R.S.A.)

L. From the following particulars prepare the Balance Sheet of the Giltedge Banking Co., Ltd., at the 31st December, 19..—

	£	s.	d.
Authorized Capital	33,000,000	–	–
Issued Capital Shares £20, £5 paid	7,070,990	–	–
Issued Capital £1 Shares, fully paid	2,249,167	–	–
Cash in Hand and with Bank of England	31,585,105	16	–
Investments	40,032,749	11	11
Profit and Loss Account, Credit Balance	1,213,200	5	6
Shares in Subsidiary Companies	2,991,715	17	6
Bank Premises	4,313,591	6	1
Money at Call and Short Notice	36,520,212	1	1
Current and Deposit Accounts	280,612,019	13	10

	£	s.	d.
Bills Discounted	36,839,342	12	10
Notes in circulation	13,934	–	–
Acceptances on behalf of Customers .	12,572,868	16	11
Advances to Customers	137,054,469	13	7
Balances with, and cheques in course of collection on, other Banks . . .	11,142,281	–	4
Reserve	9,320,157	–	–

(I.B.)

M. After writing up the Profit and Loss Account, the General Ledger balances of the Conservative Bank, Ltd., as on 31st December, were as follows: Paid up Capital, £1,500,000; Cash at Bank of England and in hand, £2,600,980; Customers' Current and Deposit Accounts, £17,580,000; Bills Discounted, Loans and Advances, £14,482,000; Freehold Premises, £380,000; Rebate on Bills Discounted, not yet due, carried to next account, £24,300; Reserve Fund, £1,200,000; English Government Securities, £520,000; Profit and Loss Account (undistributed balance), £110,680; Securities pledged with Public Bodies, £81,000; Indian and Colonial Securities, £1,101,000. On the same date (31st December) the acceptances on behalf of customers, and for which they were liable, appeared in the "Acceptance Book" of the bank at £1,725,420. Prepare a Balance Sheet as on 31st December. (L.C.C.)

N. The following is the Trial Balance of the Duckswalk Manufacturing Co. at 31st December, 19.., after the preparation of the Manufacturing and Profit and Loss Accounts for the year ended on that date—

	£	£
Share Capital— Nominal £50,000 in 50,000 Shares of £1 each		30,000
Sundry Debtors and Creditors . . .	4,400	10,560
Stock at 31st December, 19..	12,000	
Office Furniture	1,000	
Debentures at 5%, issued 1st July . .		16,000
Freehold Land	10,000	
Freehold Land, purchased 1st July . .	1,000	
Debenture Interest accrued		400
Investments (Market Value on 31st December, 19..—£7,950)	8,000	
Machinery	12,000	
Machinery, purchased 1st April . . .	2,000	
Cash at Bank	13,200	
Cash in Hand	120	
Buildings	4,000	
Buildings, additions 1st July . . .	600	
Profit and Loss Account		11,360
	£68,320	£68,320

CHAPTER XIV

INCOME TAX

ALTHOUGH dating back to the Napoleonic Wars, income tax has only within recent years assumed considerable importance in the national revenue of this country. That its yield is enormous is revealed by the fact that nearly one-half of the annual national income is to-day raised by means of income tax. As the term implies, the tax is levied on income; it is graduated in its application, as a result of which the incidence falls heaviest on those people who enjoy the largest incomes.

Income tax is imposed every year by means of the Finance Act, which determines the rate of tax payable and the various reliefs which may be claimed by the taxpayer. Whilst it is therefore possible for some variation to take place in the rates and reliefs, very little change is made in the basis on which the tax is assessed.

Definitions and Allowances.

Statutory or Gross Income. The income derived from all sources within the fiscal year, which runs from the 6th April to the 5th April following.

Assessable Income. The earned income (*less* the Earned Income Relief, see below) plus unearned and investment income.

Taxable Income. The income upon which tax is charged after all allowances and reliefs claimable have been deducted.

Standard Rate of Income Tax. This is the full rate of tax imposed under the Finance Act—1931–32 and 1932–33, 5s. in the £.

At the time of writing the undermentioned allowances are in operation—

Personal Allowance. £100 (unmarried person) and £150 (married person). Where, (in the case of a married man), the wife has an earned income, an allowance in addition to the

£150 may be claimed to the extent of four-fifths of such income, up to a maximum of £45.

Earned Income Relief. This is a relief equivalent to one-fifth of the taxpayer's earned income, up to a maximum of £300.

Children's Allowance. £50 for the first child; £40 for each additional child, living at any time during the year of assessment and under 16 years of age. Where the child has an income exceeding £50 a year, not including scholarship income, no allowance may be claimed.

Dependent Relative Allowance. £25 may be deducted where the taxpayer maintains a widowed mother or an incapacitated relative whose income from all sources does not exceed £50 a year.

Housekeeper Allowance. £50 may be claimed where a widow or widower maintains a resident female relative or stranger, or where an unmarried person maintains a widowed mother or female relative for the purpose of looking after brothers and sisters.

Life Assurance Allowance. On all policies taken out on or after 22nd June, 1916, the allowance on the annual premiums is 2s. 6d. in the £. In the case of policies taken out *before* 22nd June, 1916, the following allowances may be claimed—

Incomes up to £1,000	2s. 6d. in the £
,, exceeding £1,000 but not £2,000 .	3s. 9d. ,,
,, ,, £2,000	5s. ,,

Several restrictions apply to the premiums eligible for this allowance, chief of which are—

(*a*) The premiums must not exceed in all one-sixth of the total income.

(*b*) Relief may be claimed only on 7 per cent of the sum assured at death.

Reduced Rate Relief. This permits the first £175 of the taxable income to be taxed at 2s. 6d. in the £ or at one-half of the standard rate.

The Five Schedules.

For assessment purposes, the income of the taxpayer is divided into five classes called "schedules."

Schedule "A," which covers incomes derived from the *ownership* of lands and buildings, commonly referred to as "Property Tax" or "Landlord's Tax."

Schedule "B," which covers income and profits arising from the *occupation* of lands, known as the "Farmer's Tax."

Schedule "C," which relates to interest and dividends payable out of public funds.

Schedule "D," under which are assessed profits arising from trades, professions, and businesses.

Schedule "E," which covers salaries, fees, pensions, and wages arising from office or employment.

Schedule A.

The tax payable is based on the "annual value" of the property or the value "at which the property is worth to be let by the year." The tax may be collected either direct from the landlord or from the tenant, but where the tenant is under no obligation to pay the tax, this may be deducted from the next payment of rent made. If the owner uses the house or property solely for business purposes, he is allowed to deduct its annual value, as assessed under this schedule, from his trading profits assessed under Schedule D. Deductions are allowed for repairs and cost of maintenance as follows—

1. Lands (including farm houses and buildings) .	one-eighth of the assessment.
2. Houses and Buildings—	
(*a*) Where assessment does not exceed £40 .	one-quarter of the assessment.
(*b*) ,, ,, exceeds £40 but not £50 .	£10
(*c*) ,, ,, ,, £50 ,, £100 .	one-fifth of the assessment.
(*d*) ,, ,, ,, £100 . . .	£20, plus one-sixth of the assessment *above* £100.

Additional relief may be claimed: (*a*) Where it is proved that expenditure for repairs, etc., exceeds the statutory allowance, in which case the claim is based on the average annual expenditure for the five years preceding the year of claim. (*b*) Where the property is empty or rent is lost by the tenants having removed.

Where interest is paid to a building society either apart or included with repayment of loan, allowance may be claimed: (1) by deducting tax at the time of payment, or (2) by way of allowance from the Schedule A assessment. The claim for additional repairs must be made by the landlord within six years to the end of the fiscal year to which it relates.

Whilst the tax, payable on the 1st January, is normally charged at the full standard rate, the taxpayer may take advantage of the reduced rate relief, provided his taxable income does not exceed £175.

EXAMPLE 1. The full rental value of a house occupied by the owner is £142—

	£	£
Annual Rental		142
Less Allowance for Repairs .	20	
One-sixth (£142 – £100) .	7	
		27
Net Schedule A Assessment . .		£115

Schedule B.

The basis of assessment under this schedule is equivalent to the *gross* Schedule A assessment, except where the land is not used solely for farming purposes, in which event one-third of the gross annual or assessable value will form the basis. Persons occupying land for the purpose of husbandry may elect to be assessed under Schedule D instead of Schedule B. Where it can be proved that the actual profits fall below the Schedule B valuation, the taxpayer may claim to have the assessment reduced to the amount of the profits.

EXAMPLE 2. A farmer, married, and having two children, occupies a farm at an annual rent of £540.

	£	£
Gross Assessment		540
Less Earned Income Allowance		108
Assessable Income .		432
Less Personal Allowance . .	150	
Children's Allowance .	90	
		240
Taxable Income		£192

Schedule C.

From the student's point of view, this is of little importance, as it concerns unearned interest and dividends. Tax is collected at source—a practice adopted by the revenue authorities where possible—being deducted by the payer at the standard rate in force at the time payment of the interest is made. Where, by reason of his total income, and of the allowances and reliefs to which he is entitled, the recipient is assessable at only half the standard rate, a claim may be made for a refund of the tax deducted in excess.

EXAMPLE 3. James has taxed dividends of £400 (gross) and his wife War Loan interest (untaxed) of £100. James has no other income.

	£		
Unearned Income (£400 + £100)	500		
Less Personal Allowance	150		
Taxable Income	£350		
Tax Payable—	£	s.	d.
£175 at 2s. 6d. in the £	21	17	6
£175 at 5s. in the £	43	15	–
	65	12	6
Tax Deducted at Source—			
£400 at 5s. in the £	100	–	–
James may claim a refund of	£34	7	6

Schedule D.

Incomes under this schedule are subdivided into six classes, termed "cases." The basis of assessment, i.e. the profits earned or income received during the year preceding the year of assessment, is the same in each case, except in the last (Case VI), where the assessment is generally based on the actual income received during the year of assessment.

Cases I and II, covering profits derived from trades, professions and vocations, are of most importance from the student's viewpoint, for it is under these cases that the partnerships and limited companies are assessed. The basis of assessment, mentioned in the preceding paragraph, may be varied in exceptional circumstances, chief of which are: (*a*) a

new business; and (*b*) a business which is terminated or discontinued. In the first case, the assessment for the year during which the business was commenced will be based on the actual profit made from the date of commencing business to the 5th April following. In those cases in which a business is permanently discontinued, the assessment will be based on the profit made from the 6th April to the date of the cessation of business.

Unlike the other schedules, where the statutory income is determined by a return made by the taxpayer, profit under Schedule D is mostly calculated by reference to the Profit and Loss Account of the business. But the net profit as disclosed by this account is not necessarily the statutory profit—in fact it rarely is, for many items of expense usually charged against profit are not allowed by the Inland Revenue authorities. To this extent, therefore, it is necessary to reconstruct the Profit and Loss Account by omitting certain items, to which reference is made below.

Deductions Allowed. Repairs to business premises and to trade implements, etc., not exceeding the amount generally expended, according to the average of the three preceding years.

Debts proved to be bad; Doubtful Debts according to their estimated value.

Rent, Rates, and Lighting of business premises and offices. Where the proprietor resides in his business premises, only a portion of these expenses which relate to that part of the premises used for business purposes will be allowed.

The Schedule A assessment of any premises occupied by the owner *solely* for the purpose of business.

Wear and Tear. Depreciation is not allowed, but an amount agreed to between the inspector and the taxpayer will be passed for wear and tear.

Assurance premiums paid to a *bona fide* company.

Loss by fire, theft, or embezzlement not covered by insurance, unless such a loss be of a capital nature.

Bank Interest and Charges; Directors' Fees.

Cost of the removal of business, if removal be compulsory.

Trade and sundry expenses which are necessarily made and incurred in carrying on business.

Deductions not Allowed. Losses and expenses not connected with, or arising out of, the ordinary or normal trading of the business.

Capital withdrawn and capital expenditure, including debenture interest. (Note. In the case of financial and similar companies the cost of renewing matured debentures is allowed.)

Interest on Capital; Partners' Salaries, and Drawings; Income Tax; Depreciation.

Royalties on minerals and patents.

Voluntary subscriptions or donations to charity (except where made for the benefit of employees, and certain trade subscriptions).

Appropriations to reserves and sinking funds.

Losses recoverable under a contract of insurance.

Preliminary Expenses written off.

Contributions to employees' pension fund.

Loss on transactions of a casual nature which cannot be associated with the ordinary trading dealings of the business.

EXAMPLE 4. The Profit and Loss Account of the X Y Z Company, Ltd., for the year ending 31st December, 19 . ., was as follows—

Dr. PROFIT AND LOSS ACCOUNT *Cr.*

	£		£
To Salaries	2,000	By Gross Profit	10,000
,, Rents	260	,, Premium on Shares	250
,, Directors' Fees	1,000	,, Bank Interest	60
,, Trade Expenses	50	,, Profit on sale of Investments	1,000
,, Bad Debts	140		
,, Insurance	60		
,, Debenture Interest	240		
,, Income Tax	250		
,, Trade Subscriptions	50		
,, Preliminary Expenses written off	150		
,, Depreciation	1,950		
,, Charitable Donations	10		
,, Net Profit	5,150		
	£11,310		£11,310

Prepare an adjusted account for Income Tax purposes assuming that allowance for Wear and Tear has been agreed at £750.

ADJUSTED ACCOUNT FOR INCOME TAX PURPOSES

	£	£		£	£
To Deductions Allowed—			By Net Profit . . .		5,150
Premium on Shares .	250		,, Deductions not Allowed—		
Bank Interest . .	60		Debenture Interest .	240	
Profit on Sale of Investments . . .	1,000		Income Tax . .	250	
		1,310	Preliminary Expenses	150	
,, Wear and Tear Allowance		750	Depreciation . .	1,950	
,, Statutory Profit . .		5,690	Charitable Donations .	10	
					2,600
		£7,750			£7,750

Relief in Respect of Losses.

If, after the Profit and Loss Account has been adjusted for Income Tax purposes, a loss is revealed, this loss may be set-off against profit made in subsequent years. The right of set-off may be claimed only during six years following the year of assessment in which the loss took place. Further relief, which applies only to assessments made under Cases I and II, Schedule D, may be claimed where two or more distinct trades are carried on, which are assessable under Schedule D, and where a profit is made in one trade or trades and a loss is made in the other(s). Thus, a loss sustained in one trade may be off-set against the statutory profit made in the other trades.

Before proceeding to discuss Schedule E, it would seem advisable to dwell on the many points of distinction between the partnership and the limited company as far as the assessment and collection of tax are concerned. In the case of the partnership, whilst the business as a whole is assessed, the amount of tax payable is calculated according to the shares of the partners and the allowances to which, as individuals, they are entitled. This differs from the company which is directly responsible for the payment of tax. And, further, whilst the company is charged at the full rate, recouping itself by deducting the tax from the dividends and interest distributed, the members of a partnership, by virtue of reliefs, may be entitled to the reduced rate relief, and thus pay only a proportion of the standard or full rate of tax.

The example worked below explains the computation of the liability of the members of a partnership.

EXAMPLE 5. Swift and Sure are in equal partnership, having capitals of £7,200 and £6,000 respectively. For the year 1931–2 the profit according to the accounts amounted to £2,000, from which had been deducted Interest on Capital at 5 per cent; Partnership Salary of £300 each; Depreciation, £650; Property Tax, £50. Swift is a married man with two children (both under 16 years of age), and pays a premium of £30 on a life assurance policy dated 1924. Sure is unmarried, but maintains his sister, who acts as housekeeper.

Prepare a statement showing the partnership assessment (assuming Wear and Tear is agreed at £300) and the tax payable by each partner.

SWIFT & SURE

LIABILITY FOR INCOME TAX, 1931–2

	£	£
Profit according to books		2,000
Add back—		
Depreciation	650	
Income Tax	50	
		700
		2,700
Less Wear and Tear		300
Partnership Assessment		£2,400

	Swift		Sure	
	£	£	£	£
Share of Adjusted Profit	—	1,200	—	1,200
Interest on Capital	—	360	—	300
Salary	—	300	—	300
Individual Assessment	—	1,860	—	1,800
Less Earned Income Allowance	—	300	—	300
Assessable Income	—	1,560	—	1,500
Less Personal Allowance	150		100	
Children's Allowance	90		—	
Housekeeper Allowance	—	240	50	150
Taxable Income	—	£1,320	—	£1,350

Tax Payable—

Swift	£	s.	d.	Sure	£	s.	d.
£175 at 2s. 6d. in the £	21	17	6	£175 at 2s. 6d. in the £	21	17	6
£1,145 at 5s. in the £	286	5	–	£1,175 at 5s. in the £	293	15	–
	£308	2	6		£315	12	6
Less Life Assurance Relief— £30 at 2s. 6d. in the £ . .	3	15	–				
	£304	7	6		£315	12	6

Except in the case of companies, the tax under Schedule D is payable as to three-fourths on the 1st January and as to one-fourth on the 1st July following.

Schedule E.

The tax payable is based, with certain exceptions, on an annual return of the income received by the taxpayer during the year preceding that of assessment. Where, however, employment is commenced or discontinued during the year of assessment, the basis will be varied. In the first instance, the assessment for the first three fiscal years may be adjusted to the actual income for each year. The assessment, when employment discontinues, is reduced to the actual amount received during the year of assessment. In addition to the allowances and reliefs which may be claimed by the taxpayer as set out on pages 341–342, a further allowance is made in the case of persons of 65 years of age or over, whose incomes are derived from investment and property and do not exceed £500. This income may be treated as *earned income*, and the relief of one-fifth claimed.

For a considerable period the Schedule E tax has been payable by equal instalments on the 1st January and the 1st July following. This arrangement, however, has been changed by recent legislation and, at the time of writing, three-quarters of the tax is payable on the 1st January and one-quarter on the 1st July following.

Example 6. Smith has an earned income of £600 a year. He is married, has three children, and supports a widowed mother. Smith is insured for £750 at an annual premium of £50 (policy dated 1917).

	£	£
Earned Income		600
Less Earned Income Relief . .		120
Assessable Income . . .		480
Less Personal Allowance . . .	150	
Children's Allowance . . .	130	
Dependent Relative Allowance .	25	
		305
Taxable Income . . .		£175

Tax Payable—	£	s.	d.
£175 at 2s. 6d. in the £	21	17	6
Less Life Assurance Relief—			
£50 at 2s. 6d. in the £	6	5	-
	£15	12	6

Example 7. Brown has an earned income of £550 and an unearned income of £500 (gross). His wife has an earned income of £75. Brown is insured with two policies taken out in (*a*) 1914, for £400, annual premium, £25; and (*b*) 1921, for £500, annual premium, £50.

	£	£
Earned Income (£550 + £75)		625
Unearned Income (gross)		500
		£1,125
Less Earned Income Relief		125
Assessable Income		1,000
Less Personal Allowance . . .	£150	
Wife's Earned Income Relief .	45	
		195
Taxable Income		£805

		£	s.	d.
Tax Payable—				
£175 at 2s. 6d. in the £ . . .		21	17	6
£630 at 5s. in the £ . . .		157	10	-
		179	7	6
Less Life Assurance Relief—				
(*a*) £25 at 3s. 9d. in the £	£4 13 9			
(*b*) £35[1] at 2s. 6d. in the £	4 7 6			
		9	1	3
		170	6	3
Tax Deducted at Source—				
£500 at 5s. in the £ . . .		125	-	-
Net Amount Payable .		£45	6	3

[1] Not more than 7 per cent of the sum assured at death can be charged.

EXAMPLE 8. Clark, who is unmarried, has an earned income of £155, and income from investments of £300 (gross). He maintains a female relative to take complete charge of two orphaned brothers, both under 16 years of age.

		£
Earned Income		155
Unearned Income (gross)		300
		455
Less Earned Income Relief . . .		31
Assessable Income . . .		424
Less Personal Allowance . .	£100	
Housekeeper Allowance . .	50	
Children's Allowance . . .	90	
		240
Taxable Income		£184

	£	s.	d.
Tax Payable—			
£175 at 2s. 6d. in the £ . . .	21	17	6
£9 at 5s. in the £	2	5	-
	24	2	6
Tax already Deducted at Source—			
£300 at 5s. in the £ . . .	75	-	-
Amount of refund claimable .	£50	17	6

NOTE. In all above examples the rates and reliefs operating for 1932–3 have been assumed.

Dominion Income Tax Relief.

Though a discussion of this relief mainly concerns the work of the advanced Income Tax student, and is therefore really outside the scope of a book dealing with only the elementary points, the following notes may be of assistance to the reader.

Relief may be claimed when it is proved that for the corresponding year of assessment, the income of an individual or concern is subject to *both* British and Dominion Income Tax. The rate of the relief is calculated at either the Dominion rate of tax or one-half of the British tax, whichever is the *lower* for the year of assessment. For the purpose of determining the relief, the Dominion rate of Income Tax is ascertained by dividing the tax paid in the Dominion by the amount of the income in respect of which such tax has been charged. Similarly, the appropriate rate of British tax is arrived at by dividing the tax paid by the taxable income.

EXAMPLE 9. Henry Lorder, whose income for 1931–2 was £875 included unearned income of £250 received from a Dominion, from which tax amounting to £37 10s. had been deducted. Lorder is married, has one child, and maintains a widowed mother. Show the amount of Dominion Income Tax relief to which Lorder is entitled.

		£
Total Income		875
Less Earned Income Relief		125
Assessable Income		750
Less Personal Allowance	£150	
Children's Allowance	50	
Dependent Relative Allowance	25	
		225
Taxable Income		£525

Tax Payable—	£	s.	d.
£175 at 2s. 6d. in the £	21	17	6
£350 at 5s. in the £	87	10	–
	£109	7	6

One-half of the appropriate rate of United Kingdom Income Tax will be—

$$\frac{1}{2}\ \frac{(£109\ 7s.\ 6d.)}{£525} = 2s.\ 1d.$$

The Dominion rate of tax will be—

$$\frac{£37\ 10s.}{£250} = 3s.$$

Henry Lorder is therefore entitled to Dominion Income Tax relief at 2s. 1d. in the £ on £250 or £26 0s. 10d.

Sur-tax.

This represents an additional tax on incomes from all sources exceeding £2,000. The tax is graduated, and the 1929–30 rates were—

On the first		£2,000		Nil	
,,	next	£500	at	1s.	in the £
,,	,,	£500	,,	1s. 3d.	,,
,,	,,	£1,000	,,	2s.	,,
,,	,,	£1,000	,,	3s.	,,
,,	,,	£1,000	,,	3s. 6d.	,,
,,	,,	£2,000	,,	4s.	,,
,,	,,	£2,000	,,	5s.	,,
,,	,,	£5,000	,,	5s. 6d.	,,
,,	,,	£5,000	,,	6s.	,,
,,	,,	£10,000	,,	6s. 6d.	,,
,,	,,	£20,000	,,	7s.	,,
In excess of		£50,000	,,	7s. 6d.	,,

From 1929–30 the rates were increased by 10 per cent, so that to calculate the Sur-tax due for 1930–1 and 1931–2 or, for all time whilst the present conditions exist, 10 per cent must be added to the liability as computed by the rates given above.

EXAMPLE 10. Percy Jones derives his statutory income for 1931–2 from the following sources—

Director's Fees amounting to £3,000.
Dividends from 1,500 £1 shares at 10 per cent.
Interest on £1,000 4 per cent Victory Bonds.

His wife has unearned income totalling £250.

PERCY JONES

STATEMENT OF TOTAL INCOME FOR SUR-TAX, 1931–2

	£
Director's Fees	3,000
Dividends	150
Interest on Victory Bonds	40
Wife's Income	250
Total Income	£3,440

Sur-Tax Payable—		£	s.	d.
£2,000	Nil	–	–	–
500 at 1s. in the £		25	–	–
500 ,, 1s. 3d. ,,		31	5	–
440 ,, 2s. ,,		44	–	–
£3,440		100	5	–
	Add 10 per cent	10	–	6
		£110	5	6

Sur-tax is levied on the total income received in the year preceding that of assessment. Thus, Sur-tax on income received during the fiscal year 1930–1 would be payable on the 1st January, 1932. Where, however, the taxpayer's income includes dividends or interest from which tax has been deducted at the time of payment, the gross amount of such income received in any one year will be included in the liability for that year.

In calculating the income for the purpose of Sur-tax, the earned income allowance is not permitted as a deduction, nor may allowances obtained in respect of life assurance premiums and Dominion Income Tax be taken into consideration.

EXERCISE XIV

A. Into what Schedules is the assessment of income tax divided? Give briefly the types of income which are included in each Schedule.

B. What is meant by the following terms: (*a*) Statutory Income, (*b*) Assessable Income, (*c*) Taxable Income, (*d*) Personal Allowance, and (*e*) Life Assurance Relief.

C. Give the allowances which may be claimed for repairs, maintenance, etc., in determining the net Schedule A assessment for (1) Lands, and (2) Buildings.

D. When can a landlord obtain a greater relief for repairs under Schedule A than that automatically allowed in arriving at the net assessment? Within what limit must this claim be made?

E. A farm is let at an annual rental of £640. The owner pays a tithe of £45 and the Land Tax of £8. The tithe is assessed direct on the tithe-owner. Show the net Schedule A assessment.

F. The "adjusted balance" is that on which an assessment for income tax is calculated. Indicate four disallowed items which may account for the difference between the adjusted balance and that shown by the accounts, stating why such items are disallowed. (I.B.)

G. The following items appeared in a company's accounts and, in adjusting the Profit and Loss Account for income tax purposes, how would you deal with them—

(*a*) Bank interest received.
(*b*) Subscriptions and donations.
(*c*) Additions to plant.
(*d*) Legal expenses.
(*e*) Expenses on formation of company.
(*f*) Interest paid on debentures.

H. What do you understand by the term "statutory profit"? How is this arrived at, and what deductions are (*a*) allowable, and (*b*) not allowable?

I. From the following Profit and Loss Account of the Blandford Manufacturing Co., Ltd., prepare Adjusted Account for income tax purposes—

Dr. PROFIT AND LOSS ACCOUNT *Cr.*

	£		£
To Office Expenses	2,500	By Gross Profit	8,900
,, Repairs	750	,, Transfer Fees	50
,, Renewals	1,000	,, Bank Interest	350
,, Rent and Rates	150	,, Miscellaneous Receipts	30
,, Insurance	75		
,, Depreciation	500		
,, Legal Expenses	25		
,, Income Tax	120		
,, Preliminary Expenses	240		
,, Underwriting Commission	150		
,, Debenture Discount	130		
,, Bad Debts Reserve	250		
,, Net Profit	3,440		
	£9,330		£9,330

Wear and Tear has been agreed at £300, and the Inspector of Taxes has agreed to allow 60 per cent of the Reserve for Bad Debts. Included in the legal costs is an item of £10 incurred in connection with the purchase of additional property.

J. State the circumstances in which a loss sustained in one business can be set-off against a profit made in another. To what schedule does this relief apply?

K. Thomas Green resides in part of his business premises. What claim, if any, can Green make in calculating his business profits under Schedule D?

L. For the purpose of Dominion Income Tax Relief, what is meant by the term "appropriate rate of United Kingdom Tax"?

M. Norman Newman's income for 1931–2 was £670 earned, and £20 from dividends (taxed at source). He is married, has one child, and pays a premium for a policy on his own life of £60 a year (dated, 1915). Show the tax payable by Newman for 1931–2.

N. George Green, who was born in 1861, earns a salary of £210 per year. He is unmarried and maintains a widowed sister. He derives in addition to the salary, income from investments amounting to £270 per annum taxed at source. You are required to calculate the repayment which Green may claim for 1931–2.

O. William Clifford had the following income for 1932–3—

Salary	£1,500
Dividends (taxed) . .	350
Earned Income (wife) . .	250

Clifford has four children (two over 16 years of age attending a secondary school—the elder receiving a grant of £110). He maintains his wife's widowed mother, and pays the following assurance premiums yearly—

(*a*) £60 on a policy for £4,000 taken out in 1913.

(*b*) £30 on a policy for £200 taken out in 1930.

You are required to show Clifford's liability for income tax.

P. Jones is a married man and has five children, all under 16 years of age. He has a salary of £990 per annum. In addition he receives dividends of £100 (gross). He owns his own house, assessed under Schedule A at £60 net. He supports a dependent relative. His life is assured for £1,000 under a policy dated June, 1918, the premium being £120. Show Jones' income tax computation for 1931–2.

Q. Maurice Clark has an earned income of £800. His wife's earnings total £250. There are four children, three being under 16 years of age. Clark maintains his wife's widowed mother, who has an income of £35 a year. You are required to show Clark's liability for tax for 1932–3.

R. Percy Cole derives his income from the following—

£11,000 10 per cent Preference Shares.

£7,000 Ordinary Shares (dividend at 10 per cent free of tax).

He is married and has three children. He is insured for £6,000, policy taken out in 1913 on which he pays an annual premium of £80. Show the amount of income tax payable by Cole for 1932–3.

S. John, James, and Jack are in partnership. The net profits, after deducting interest on capital at 5 per cent and partners' salaries, are shared equally. The capitals were, John, £8,000; James, £5,000; and Jack, £2,000. John and James each receive a salary of £250 per annum. The profit for the year as accepted by the Inspector of Taxes was £3,155. You are required to prepare a statement showing the individual amounts upon which tax is assessable.

T. Brown's income for 1930–1 was £7,350. Ascertain the amount of sur-tax Brown is required to pay. What would have been the difference had the assessment been for 1929–30?

ANSWERS TO EXERCISES

EXERCISE I

(H) £1,000. **(J)** Balances; Profit, £269, Goods, £2,250, Due to Wilkinson, £313. **(K)** Trial Balance, £2,150.

EXERCISE II

(D) Gross Profit, £5,106; Net Profit, £1,767; Balance Sheet, £12,035. **(E)** Gross Profit, £5,883; Net Profit, £2,956; Balance Sheet, £13,027. **(F)** Gross Profit, £684 14s.; Net Loss, £158; Balance Sheet, £1,676 10s. **(G)** Gross Profit, £6,500; Net Profit, £4,000; Balance Sheet, £9,600. **(H)** Gross Profit, £6,530; Net Profit, £2,654; Balance Sheet, £26,895. **(I)** Gross Profit (after taking Warehouse Wages, Expenses, and Heating into account), £8,418; Net Profit, £1,522; Balance Sheet, £26,953.

EXERCISE IV

(H) Capital Accounts; Jones, £33,200, Robinson, £8,950. **(I)** Opening Balance Sheet, £20,532; Opening Capitals, Dot, £9,304, Dash, £6,036, Blank, £2,000; Share of Profit, Dot, £3,223 7s., Dash, £2,148 18s., Blank, £1,790 15s. **(J)** Balance Sheet, £2,700. **(K)** Opening Balance Sheet, £4,900; Shares of Partners, Hooper, four-ninths, Capel, two ninths, Lucas, one-third. **(L)** Cash Book, Debit Entries of £3,000 and £1,500, Credit Entry of £1,500; A.B. Capital Account, Credit Entry of £3,000; X Y Capital Account, Debit and Credit Entries of £1,500. **(M)** £4,596 2s. **(N)** Realization Profit, £373; Black, £3,236 10s. White, £1,146 10s. **(O)** Realization Loss, £2,000; Cash Distributed, A, £2,000, B, £500, C, £900. **(P)** Realization Loss, £162; Cash Distributed, X £269, Y £376, Z £73. **(Q)** Realization Loss, £1,200; Cash Distributed, X £600, Y £200, Z £400. **(R)** Realization Profit, £2,983; Cash Distributed, A £4,488 13s. 4d., B £3,494 6s. 8d. **(S)** Capital Accounts, A £8,250, B £5,250. **(T)** Gross Profit, £6,500; Net Profit, £3,394; Balance Sheet, £11,936. **(U)** Gross Profit, £7,138; Net Profit, £2,370; Balance Sheet, £10,480. **(V)** Gross Profit, £9,990; Net Profit, £5,604; Balance Sheet, £12,298 10s. **(W)** Gross Profit, £2,178; Net Profit, £503; Balance Sheet, £4,001. **(X)** Gross Profit, £11,306; Net Loss, £5,620; Balance Sheet, £85,810; Capital Accounts, Lion, £55,310, Unicorn, £26,640. **(Y)** Gross Profit, £22,904; Net Profit, £9,221 15s.; Balance Sheet, £23,137 15s. **(Z)** Gross Profit, £23,182; Net Profit, £9,436; Balance Sheet, £66,266.

EXERCISE V

(K) Balance Sheet, £97,000; Calls in Arrear, £1,250; Forfeited Shares, £2,000. **(N)** Balance Sheet, £33,780; Premium on Shares, £30. **(O)** Trial Balance, £56,262 10s.; Premium on Shares, £6,262 10s. **(P)** Balance Sheet, £61,575; Premium on Shares, £1,575. **(R)** Premium on Shares,

£50. (**T**) Liabilities, Debentures, £100,000; Assets, Debenture Discount, £4,000, Underwriting Commission £3,000; Cash, £93,000. (**U**) Premium on Shares, £180. (**V**) Capital, £50,000; Discount on Shares (Asset), £1,000. (**W**) Premium on Shares, £55. (**Y**) Debentures reduced to £10,000, Profit to £6,610, Cash to £6,500; Capital Reserve (credit), £10,000. (**Z**) Debentures, £10,000 (Liability); Debenture Discount, £2,000 (Asset); Cash, £9,800.

EXERCISE VI

(**J**) Balance Sheet, £150,000. (**K**) Profit and Loss (balance), £6,743. (**L**) Profit and Loss (balance), £3,611. (**N**) Gross Profit, £19,547; Net Profit, £9,758; Balance Sheet, £97,504. (**O**) Gross Profit, £13,005; Net Profit, £2,457; Balance Sheet, £85,704. (**P**) Gross Profit, £39,677; Net Profit, £8,111; Balance Sheet, £306,433. (**Q**) Gross Profit, £11,463; Net Profit, £3,068; Balance Sheet, £31,186. (**R**) Gross Profit, £23,108; Balance of Profit, £14,575; Balance Sheet, £91,425. (**S**) Gross Profit, £46,100; Net Profit (balance), £5,546 10s.; Balance Sheet, £117,562 10s. (**X**) Balance of Profit, £37,500. (**Z**) Purchase Price, £87,500; Realization Profit, £19,300.

EXERCISE VII

(**G**) Profit, "A" £2,696; "B" £2,044; "C" £555; "D" £3,685. (**H**) Profit; Works, £20,545; Retail, £11,404; Net Profit, £17,218; Balance Sheet, £98,273. (**I**) Profit; "A," £31,270; "B," £9,790; Net Profit, £20,275; Balance Sheet, £163,175. (**J**) Profit; "W," £2,149; "C," £4,891; "S," £8,540; Net Profit, £8,520; Balance Sheet, £25,400.

EXERCISE VIII

(**E**) Net Profit, £823 10s. 11d. (**F**) Net Profit, £1,095 8s. 1d. (**H**) Stocks; "A," £5,446; "B," £1,776; "C," £3,494; "D," £8,495. (**I**) Stocks; Sheffield, £11,260; York, £9,911; Leeds, £3,828. (**J**) Net Profit, £46[illegible]9s. 2d. (**K**) Net Profit, £829 6s. 4d. (**L**) Net Profit, £1,625 5s. 7d.; Balance Sheet, £3,553 15s. 11d. (**M**) Gross Profit, £1,804; Net Profit, £1,033. (**O**) Gross Profit, Head Office, £32,974 13s. 11d. Branch A, £16,143 6s. 5d. Branch B, £6,583 14s. 7d. Net Profit; Head Office, £26,739 16s. 9d. Branch A, £11,609 2s. 9d. Branch B, £3,261 4s. 1d. Balance Sheet, £131,120 17s. 5d. (**T**) (*a*) 35887.81; (*b*) 2418.06; (*c*) 3832.91; (*d*) 119631.61. (**U**) Difference in Exchange, £2 6s. 3d.; Trial Balance, £6,237 6s. 4d. (**V**) Gross Profit, £748 0s. 11d.; Net Profit, £289 9s. 8d.; Balance Sheet, £3,280 16s. (**X**) (*a*) £40 2s. 10d. (*b*) £1,809 19s. 6d. (*c*) £104 12s. 8d.

EXERCISE IX

(**E**) Balance, £2,397. (**G**) Balances: Bought Ledger, £2,673; Sales Ledger, £4,025. (**M**) Balance, £11,642.

EXERCISE X

(**C**) Surplus of Income over Expenditure, £298; Balance Sheet, £1,315 10s. (**F**) Payment to Landlord (Fourth Year), £1,200. (**G**)

Payment to Landlord (Fourth Year), £875. (**H**) Shortworkings unrecouped, £50. (**K**) Balance (R.D.), £629. (**M**) Percentages:

Year 1,	Gross Profit, ·2;	Overheads, ·1;	Net Profit, ·1
,, 2,	,, ,, ·15;	,, ·8;	,, ,, ·7
,, 3,	,, ,, ·125;	,, ·6;	,, ,, ·65.

(**N**) Amount of Claim, £4,600. (**P**) (1) £7; (2) £5 (3) £12; (4) £3 10s.; Net Profit, £3,507. (**Q**) Gross Profit, £10,700; Net Profit, £6,520; Balance Sheet, £58,250. (**U**) Loss, £2,125; Capital, £3,075; Balance Sheet, £4,950. (**W**) Profit, £618. (**Y**) A B's profit, £103 15s. (**Z**) Income, £141 0s. 6d.; Profit on Sale, £16 15s. 9d.

EXERCISE XI

(**T**) 3s. in the £. (**U**) 7s. in the £. (**V**) 10s. in the £. (**W**) Deficiency, £9,820. (**Y**) Amount Distributed, £8,600; 14s. 4d. in the £. (**Z**) Preference Shares in full; Ordinary Shares at 10s. in the £.

EXERCISE XII

(**L**) Balance Sheet, £313,052,336 16s. 3d. (**M**) Balance Sheet, £22,140,200. (**N**) Capital Account Balance, £15,400; General Balance Sheet, £37,720. (**O**) Capital Account Balance, £22,000; General Balance Sheet, £73,100. (**P**) Profit; Fire Insurance, £12,284; General Insurance, £23,760; Balance Sheet, £885,521.

EXERCISE XIII

(**S**) (*a*) £20; (*b*) £25. (**T**) Net Cost per cwt., £2 11s. 0·7d. (**U**) Cost per ton, £5 1s. 1d.

EXERCISE XIV

(**E**) £507. (**I**) Statutory Profit, £5,040. (**M**) £54 12s. 6d. (**N**) £24 13s. 6d. (**O**) £226 7s. 6d. (**P**) £71 2s. 6d. (**Q**) £100 12s. 6d. (**R**) £109 7s. 6d. (**S**) John, £1,285; James, £1,135; Jack, £735. (**T**) £826 7s. 6d.; Difference, £75 2s. 6d.

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